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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

AMERICAN FIDELITY LIFE INSURANCE COMPANY, CHARLES P. WOODBURY, JOSEPH F. MARQUES, JR., R. E. MAUCH AND RICHARD MERTINS,
Petitioners

v.

ALABAMA FARM BUREAU MUTUAL CASUALTY INSURANCE COMPANY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Petitioners

v.

ALABAMA FARM BUREAU MUTUAL CASUALTY INSURANCE COMPANY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

American Fidelity Life Insurance Company ("AMFI") and certain of its individual directors and officers, Charles P. Woodbury, Joseph F. Marques, Jr., R. E. Mauch and Richard Mertins, petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.[1] The grant of certiorari is required because the

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[1] Although count I of this action, the only count at issue in this petition, is a derivative claim brought by Alabama Farm Bureau Mutual Casualty Insurance Company, Inc. ("Alabama Farm")

decision of the Fifth Circuit is contrary to this Court's reasoning in *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977), and is in direct conflict with decisions of the Second, Third, Seventh, Eighth and Ninth Circuits.

OPINIONS BELOW

The opinion of the Court of Appeals (App. A, *infra*) is officially reported at 606 F.2d 602. The memorandum and order of the District Court (App. B, *infra*) is unreported.

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on behalf of AMFI because of alleged wrongs done by AMFI's officers and directors (the individual petitioners herein and Terry M. Richardson, another director, now deceased), AMFI also has a direct interest in the resolution of the issues presented and is thus a proper petitioner in this Court. Counts III and IV in Alabama Farm's complaint, also dismissed by the District Court, state pendent state law claims against AMFI and others. Such pendent claims, by reason of the Court of Appeals' reversal and reinstatement of the federal law claim in count I, also may be reinstated. If, as petitioners submit, the Court of Appeals' judgment as to count I is in error, this entire action will be properly dismissed, including those pendent claims brought against AMFI. *United Mine Workers* v. *Gibbs,* 383 U.S. 715 (1966); *Tully* v. *Mott Supermarkets, Inc.,* 540 F.2d 187 (3d Cir. 1976).

In addition, as discussed further below, this litigation was commenced by Alabama Farm not as an adequate representative of AMFI's shareholder body in order to seek correction of some alleged wrong to the corporation, but rather for its own individual purposes in furtherance of its goal of obtaining control of AMFI. *See infra* at 20, n. 14. Thus, AMFI has a legitimate interest, separate and apart from the interest of its officers and directors, in pursuing its independent rights in this Court. *Cf. Messing* v. *FDI, Inc.,* 439 F. Supp. 776, 781-782 (D.N.J. 1977); *Otis & Co.* v. *Pennsylvania R.R.,* 57 F. Supp. 680 (E.D. Pa. 1944), *aff'd,* 155 F.2d 522 (3d Cir. 1946).

JURISDICTION

The judgment of the Court of Appeals (App. C, *infra*) was entered on November 15, 1979. The Court of Appeals denied a petition for rehearing and rehearing *en banc* on January 15, 1980 (App. D, *infra*). On January 21, 1980, the Court of Appeals granted a stay of the issuance of the mandate (App. E, *infra*) to February 20, 1980, and subsequently extended the stay to March 7, 1980 (App. F, *infra*). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether, consonant with this Court's decision in *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977), allegations of an undisclosed motive by directors to retain existing corporate control relationships in connection with effectuation of an otherwise fully disclosed stock repurchase program to purchase company stock in the open market are sufficient to state a derivative claim under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder and thereby convert a traditional state law claim of corporate waste into a federal securities violation.

2. Whether, even if such an undisclosed motive is not required to be disclosed in connection with a stock repurchase program to purchase company stock in the open market, such an undisclosed motive may make the stock repurchase program a "manipulative device" in violation of Section 10(b) and Rule 10b-5.

3. Whether, even assuming the nondisclosure of such alleged motive constitutes manipulation or deception under Section 10(b) or Rule 10b-5, it is sufficient to allege only that if disclosure had been made a stock-

holder would have been able to assert state law remedies in a state court, without also demonstrating, as is required by decisions of the Seventh and Ninth Circuits, that one would have prevailed in the assertion of such state law remedies.

STATUTE AND REGULATION INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

Petitioner American Fidelity Life Insurance Company (hereafter "AMFI") is a life insurance company headquartered in Pensacola, Florida. In October 1973, the price of its stock, traded over the counter, was below $10 per share after having previously reached $45 per share in January 1973. [R.752; J.A. 439].[2] Feeling, as did many other public companies at that time, that the market was substantially undervaluing its shares, a committee of AMFI's Board of Directors voted to have AMFI repurchase up to $2 million worth of its stock in the open market. [R.773; J.A. 464]. The full Board of AMFI thereafter authorized the repurchase program in October 1973. [R. 749, 775-776; J.A. 436, 466-467].

Independent of the AMFI Board's consideration to repurchase, Alabama Farm Bureau Mutual Casualty Insurance Company, Inc. (hereafter "Alabama Farm") evidently concurred in the Board's assessment that AMFI's stock was undervalued, and, in October 1973, it began its own program to purchase AMFI stock. [R.791-793; J.A. 486-488].[3] By September 1974,

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[2] "R." refers to the record in the District Court. "J.A." refers to the Joint Appendix in the Court of Appeals. "App." refers to the appendix to this petition.

[3] In a Schedule 13D filed with the Securities and Exchange Commission ("SEC") in December 1973, and in subsequent amendments thereto, Alabama Farm stated that it "feels that the securities of the issuer [AMFI] are selling at much less than is

it had purchased over 360,000 shares or about 24 percent of the then outstanding stock. [R.846; J.A. 554].

AMFI began its repurchase program in January of 1974. An AMFI press release, issued on January 2, 1974, stated that the AMFI Board of Directors had authorized the purchase of up to $2 million of its common stock in the open market, that the purchases would be made over an extended period of time,[4] that a decrease in both "capital" and "surplus" could be expected, and that no time limitation had been placed on the purchases. [R.824; J.A. 528]. Over the ensuing nine months, AMFI made six additional public disclosures in connection with the stock repurchase program.[5] By February 1975, AMFI had acquired 314,535

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normal for a life insurance company with the amount of business in force as has American Fidelity." [R.751-752, 791-805; J.A. 438-439, 486-506].

[4] On December 6, 1973, the SEC issued revised proposed rules governing the repurchase by a corporation of its own stock. Securities Exchange Act Release No. 10539 (December 6, 1973), [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,600. Proposed rules were first published on July 13, 1970. *See* Securities Exchange Act Release No. 8930 [1969-1970 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,837. One of those rules places strict upper limits on the amounts of purchases of its own securities an issuer may make on a given day. *See* 17 C.F.R. 240.13e-2.

[5] The disclosures were: (a) a February 28, 1974, press release which noted that the company's stock repurchase program resulted in a contingent tax liability of $745,000 chargeable against 1973 GAAP earnings [R.825-826; J.A. 530-532]; (b) AMFI's 1973 Annual Report, mailed on March 28, 1974, which was to the same effect [R.817; J.A. 519]; (c) a report at AMFI's annual stockholders' meeting on April 23, 1974, that 165,626 shares had been repurchased as of that date and that $1,404,646.82 had been expended in so doing (an Alabama Farm Vice President in attendance voted Alabama Farm's shares in favor of ratifying the repurchase program) [R.827-828; J.A. 534-535]; (d) an April 24,

of its own shares at an average price of $8.51 per share. [R.851; J.A. 559].

Count I of Alabama Farm's amended complaint alleged derivatively on behalf of AMFI that the individual directors violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, in that they caused AMFI to undertake the stock repurchase program without a valid corporate purpose and to have wasted AMFI's funds in order to preserve their own positions of "control." [R.846-852; J.A. 554-560]. The complaint further alleged that the repurchase program artificially inflated the market price of AMFI's shares, thereby discouraging others from purchasing AMFI stock or attempting to gain control of AMFI. [R.848; J.A. 556]. On the theory that AMFI suffered injury by having its statutory capital and surplus depleted in making these purchases at open market prices which were above AMFI statutory book value, Alabama Farm claimed damages to AMFI of $3,423,078. [R.860; J.A. 568].

Petitioners moved to dismiss the complaint, or in the alternative, for summary judgment, and the District Court granted petitioners' motion with respect to all counts of the complaint. [App. 41a.] The Court of Appeals subsequently reversed that judgment with respect to count I. [App. 26a].[6]

1974 press release which noted that AMFI would continue the repurchase program and retain the repurchased shares as treasury stock [R.829-830; J.A. 537-539]; (e) AMFI's Mid-Year Report, mailed on August 1, 1974, providing additional information [R. 834-835; J.A. 544-545]; and (f) a September 24, 1974 press release which stated that the amount authorized for repurchase had been increased to 3 million dollars. [R.823; J.A. 526].

[6] Count II charged violations of Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a), and Rule 14a-9 there-

Decision Of The District Court

The District Court concluded that AMFI had "fully disclosed its stock repurchase program to the stockholders and the public. No buyer or seller was deceived as to either the existence or size of the program." [App. 36a]. The Court found no authority for the proposition "that corporate managers must disclose not only the facts underlying a stock repurchase program but must also reveal their subjective motivations." [App. 36a]. It held that Alabama Farm's allegations of "deception" amounted to no more than charges of corporate mismanagement, insufficient to state a claim under the federal securities laws. [App. 37a].

The Court also concluded that since all purchases of stock had been made on the open market at prevailing market prices, neither AMFI nor any buyer or seller of AMFI stock had been injured. It rejected Alabama Farm's "novel theory" that AMFI's purchases of its stock at fair market prices in excess of "statutory book value" constituted injury, noting that "current market price is commonly considered a fair measure of value." [App. 37a].[7]

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under, 17 C.F.R. § 240.14a-9. The District Court's decision in petitioners' favor on that count was affirmed by the Court of Appeals. Counts III and IV asserted pendent state law claims and were dismissed by the District Court without prejudice. *See supra* note 1.

[7] This principle is in accord with the "efficient market theory" espoused by the Second and Seventh Circuits, which holds that where there is a free and actively traded market, it is the market price of a stock rather than other factors, such as book or net asset value, which establishes the value of a company on a "going concern" basis. *Seaboard World Airlines, Inc.* v. *Tiger International, Inc.*, 600 F.2d 355, 361-362 (2d Cir. 1979); *Mills* v. *Electric Auto-Lite Co.*, 552 F.2d 1239, 1247 (7th Cir.), *cert. denied*, 434 U.S. 922 (1977).

Decision Of The Court Of Appeals

A three-judge panel of the Court of Appeals, consisting of Circuit Judges Hill and Rubin and Senior Judge Skelton of the United States Court of Claims (sitting by designation), reversed the decision of the District Court on count I. Judge Skelton dissented.

The Court of Appeals first acknowledged that (i) a breach of fiduciary duty by corporate officers or directors without any manipulation, deception, misrepresentation or nondisclosure does not constitute a violation of Section 10(b) or Rule 10b-5 [App. 7a]; (ii) the failure of a corporate official to disclose his motives in entering into a transaction does not constitute the "deception" required for a violation [App. 11a]; and (iii) it normally is not necessary for corporate officers to characterize the various potential effects of a transaction as favorable or unfavorable or to evaluate the overall effect of the transaction, such characterization being a matter of judgment not fact [App. 12a-13a].[8]

However, in an incongruous shift of its analysis, the Court found that "read as a whole" the complaint asserted a scheme "artificially to manipulate the market and artificially (that is, beyond the operation of normal market factors) to inflate prices," in order to discourage others from purchasing shares and thereby to perpetuate existing control relationships within the corporation. [App. 14a]. Moreover, even if the alleged scheme itself did not amount to a "manipulative device" within Rule 10b-5, the Court concluded that Ala-

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[8] Thus, for example, the Court said "[i]t was unnecessary for AMFI to outline any or all of the possible dangers that could be posed by a decrease in statutory capital and surplus; the disclosure that they would be decreased was adequate." [App. 13a].

bama Farm had adequately alleged "deception" in the directors' failure to disclose to the public that their alleged motive in voting for the repurchase plan was to benefit their own control position by having the plan carried out in a manner that would artificially inflate the stock's price, and thus deter others from buying AMFI stock. [App. 17a].

The Court next found that under Florida law there would have been "a reasonable basis" for Alabama Farm, as a representative of the shareholders, to seek relief in state court had they only been aware of the directors' undisclosed motive. [App. 19a-20a]. It characterized the remaining question as being whether Alabama Farm had to demonstrate both that it could have brought such a state court action and that it would have prevailed in such action, or only that it properly could have brought such an action and that the alleged facts made out a prima facie case. Disregarding decisions of the Seventh and Ninth Circuits to the contrary, as well as all considerations of the lack of representativeness of Alabama Farm,[9] the Court held that "all that is required to establish 10b-5 liability is a showing that state law remedies were available and that the facts shown make out a prima facie case for relief." [App. 19a].

Judge Skelton, in dissent, found no manipulation under *Santa Fe,* no deceit or fraud, and no allegation by Alabama Farm of "any fact that shows any purpose, plan or intent on the part of AMFI to inflate the market price of its stock by its repurchase plan. Furthermore, the execution of the plan by AMFI did

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[9] *See infra* note 14.

not inflate the market price of its stock." [App. 28a]. Judge Skelton concluded:

> [AMFI] purchased the stock in small lots over a long period of time. No one was deceived or misled. The price of the stock was not inflated by reason of its purchases.
>
> . . . Rule 10b-5 was not violated because there was no "deception" of or "injury" to the plaintiffs in connection with the repurchase program. . . . [T]here is no genuine issue of any material fact on this part of the case.

[App. 29a].

REASONS FOR GRANTING THE WRIT

On the central issue in this case—whether AMFI's directors, in failing to disclose to the stockholders their alleged motive in voting to undertake the stock repurchase program, made use of a manipulative or deceptive device under Section 10(b) of the Exchange Act and Rule 10b-5—the decision of the Court of Appeals is contrary to this Court's reasoning in *Santa Fe Industries, Inc.* v. *Green.* It also is in direct conflict with decisions of United States Courts of Appeals for three different circuits: *Rodman* v. *Grant Foundation,* 608 F.2d 64 (2d Cir. 1979); *Biesenbach* v. *Guenther,* 588 F.2d 400 (3d Cir. 1978); and *Golub* v. *PPD Corp.,* 576 F.2d 759 (8th Cir. 1978). Moreover, by allowing allegations of improper motive in adopting otherwise proper corporate transactions to make out a 10b-5 claim, the decision of the Court of Appeals converts a fundamental state law claim into a federal securities action and virtually precludes dispositions short of trial, thereby fostering the very kind of harassing

and intimidating litigation intended to be foreclosed by this Court's decisions in *Santa Fe Industries, Inc.* v. *Green,* and *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975).

On another important issue in the case—whether causation may be established for Rule 10b-5 purposes by showing only that state law remedies would have been available had full disclosure been made, or whether it also must be demonstrated that one would have prevailed in a state court action—the decision of the Court of Appeals by its own admission is in direct conflict with decisions of United States Courts of Appeals for two different circuits: *Wright* v. *Heizer Corp.,* 560 F.2d 236 (7th Cir. 1977), *cert. denied,* 434 U.S. 1066 (1978), and *Kidwell ex rel. Penfold* v. *Meikle,* 597 F.2d 1273 (9th Cir. 1979). Consideration by this Court therefore is necessary both to assure adherence to its own major decisions in the securities field and to secure and maintain uniformity of decisions among the circuits.

1. The Decision Of The Court Of Appeals Is Contrary To This Court's Reasoning In *Santa Fe Industries, Inc.* v. *Green* And To Decisions Of The United States Courts Of Appeals For The Second, Third And Eighth Circuits.

While paying lip service to this Court's reasoning in *Santa Fe,* the Court of Appeals broadly interpreted the meaning of Section 10(b) of the Exchange Act and Rule 10b-5 to include standard corporate stock transactions, such as the stock repurchase program involved here, if done with an alleged motive by the directors to inflate artificially the price of the corporate stock and thereby to deter other potential purchasers from investing, all in an effort to preserve existing corpo-

rate control relationships. In essence, the Court held that even when all material facts concerning such a standard corporate transaction are fully disclosed, simply pleading that the undisclosed motivation for the transaction is a desire by directors to maintain control of the corporation is sufficient to state a claim under Section 10(b).

a. There was no deception.

In *Santa Fe,* this Court put to rest any notion that breaches of fiduciary duty without any charge of misrepresentation or lack of disclosure create a claim under Section 10(b): "Once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute." 430 U.S. at 478. Here, the Court of Appeals agreed with the findings of the District Court that the directors had fully disclosed all the material terms of the stock repurchase program and all of the facts relating thereto.[10] Thus, the only issue is whether an allegation that the directors had the maintenance of existing corporate control relationships as their motive in approving a fully disclosed stock repurchase program creates Section 10(b) liability under *Santa Fe.*

While no such allegations of undisclosed motives were raised in *Santa Fe,* this Court in that case

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[10] The Court of Appeals concluded that the District Court was correct in finding that AMFI had "adequately disclosed" the existence of the repurchase plan and the "size and scope" of the plan, as well as other subsequent material facts which developed as the program progressed, including the anticipated decrease in AMFI's "capital" and "surplus." [App. 13a]. And, as Alabama Farm conceded in its amended complaint, AMFI's purchases were made "on the open market" at the prevailing market prices. [R. 851; J.A. 559].

reaffirmed its reluctance to adopt a "federal fiduciary principle," by stating that the alleged absence of a proper corporate purpose for an otherwise valid corporate transaction (and presumably the nondisclosure of that absence) did not create a federal securities claim. 430 U.S. at 479-480. The Court of Appeals ignored that proscription.

Since *Santa Fe,* four different United States Courts of Appeals have had occasion to consider whether the nondisclosure of directors' motives in approving an otherwise fully disclosed and proper corporate transaction is a violation of Section 10(b) and Rule 10b-5 under this Court's reasoning in *Santa Fe.* Except for the Court of Appeals in this case, each has said that subjective interests and motives are not required to be disclosed.

Rodman v. *Grant Foundation,* 608 F.2d 64 (2d Cir. 1979), like this case, involved a stock repurchase program which allegedly was undertaken with the motive of retaining existing control relationships. The District Court, in dismissing the complaint, had held that failure to disclose "[one's] subjective interest does not violate the securities laws," and it dismissed the claim. 608 F.2d at 71. On the basis of this Court's decision in *Santa Fe,* the Second Circuit affirmed the dismissal and held that the failure to disclose an intent to consolidate or retain control is not actionable under Section 10(b):

> [T]he Supreme Court in *Santa Fe Industries* v. *Green,* had specifically rejected the proposition that "a breach of fiduciary duty by majority stockholders, without any deception, misrepresentation, or nondisclosure," violates Section 10(b) or Rule 10b-5. The Court expressed its adherence

> to the proposition that "Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement." . . .
>
> *Our concern here, as in most cases under the Securities Acts, is whether there has been full and fair disclosure. . . . Appellant's charges, while paying lip service to that doctrine, really allege nothing more than corporate mismanagement. . . .* [E]very purchase by a corporation of its own stock serves to some extent to consolidate the control of existing management. The Securities Acts do not require that a full disclosure of this fact be made to shareholders whenever a corporation purchases any shares of its own stock regardless of the size of the purchase or the use to which the purchased stock is put. There is no contention here that the directors hid from the shareholders the making of the purchases. . . .

608 F.2d at 72-73 (emphasis added) (citations omitted).

Biesenbach v. *Guenther*, 588 F.2d 400 (3d Cir. 1978), was a derivative suit against a majority of directors, alleging that they had arranged self-dealing transactions in order to pursue their own goal of gaining complete control of the corporation. The District Court dismissed the complaint, holding that the complaint failed to allege the use of "any manipulative or deceptive device" under Section 10(b) and Rule 10b-5. On appeal, it was argued that, because the defendants' alleged motives of gaining control had not been disclosed, the Court had erred in its failure to find an allegation of "deception." The Third Circuit affirmed the dismissal, concluding that under this Court's decision in *Santa Fe* allegations concerning the failure to dis-

close "the true purpose behind the activities" did not constitute the kind of deception, misrepresentation or nondisclosure required by Section 10(b) or Rule 10b-5. To reach the opposite conclusion, stated the Court, "would clearly circumvent the Supreme Court's holding in *Santa Fe.*" 588 F.2d at 402.

Similarly in *Golub* v. *PPD Corp.*, 576 F.2d 759 (8th Cir. 1978), the Eighth Circuit affirmed the dismissal of a claim that the directors' motives were required to be disclosed, stating:

> Actually, the plaintiffs are not complaining about any absence of facts in the proxy statement. Their complaint is that those who prepared the statement did not "disclose" what the plaintiffs say was the true motivation of Old PPD's management in selling the assets of the company, and did not characterize the bonus aspect of the transaction as plaintiffs would have it characterized. Under the Act and regulations plaintiffs were not entitled to have such a "disclosure" or such a characterization.

576 F.2d at 765.[11]

b. There was no manipulation.

The Court of Appeals in this case at one point seemed to recognize that an individual's motives or subjective beliefs were not disclosure items and even cited *Golub* v. *PPD* for that proposition. [App. 12a-13a]. But

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[11] Numerous decisions of the United States District Courts interpreting *Santa Fe* have reached the same result. *See Lewis* v. *Oppenheimer & Co.*, [1980] Fed. Sec. L. Rep. (CCH) ¶ 97,229 (S.D.N.Y. December 26, 1979); *Hundahl* v. *United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1365 (N.D. Tex. 1979); *Tyco Laboratories, Inc.* v. *Kimball*, 444 F. Supp. 292 (E.D. Pa. 1977); *Falkenberg* v. *Baldwin*, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,086 (S.D.N.Y. 1977).

while it accepted in the first half of its opinion that subjective motives and beliefs need not be disclosed, the Court made its fundamental error by concluding that an alleged undisclosed motive made the entire stock repurchase plan a "manipulative device" such that disclosure of the alleged motive was required. [App. 14a].

Santa Fe does not permit such a conclusion. Alleging that an otherwise proper corporate transaction was occasioned by improper motives cannot transform that otherwise proper transaction into a "manipulative" device within the meaning of Section 10(b). As this Court stated in *Santa Fe*:

> "Manipulation" is "virtually a term of art when used in connection with securities markets." [Quoting *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 199 (1976)]. The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity.
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> * * *
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> Section 10(b)'s general prohibition of practices deemed by the SEC to be "manipulative"—in this technical sense of artificially affecting market activity in order to mislead investors—is fully consistent with the fundamental purpose of the 1934 Act "to substitute a philosophy of full disclosure for the philosophy of caveat emptor. . . ."
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> * * *
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> But we do not think it [Congress] would have chosen this "term of art" if it had meant to bring within the scope of Section 10(b) instances of corporate mismanagement such as this, in which the essence of the complaint is that shareholders were treated unfairly by a fiduciary.

430 U.S. at 476-477. *See also Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 199, 214 (1976). Unlike the manipulative practices described in *Santa Fe,* a fully disclosed stock repurchase program is a standard form of corporate transaction which, when effectuated on the open market and with full disclosure of its terms, as was this one, cannot be equated with a device "artificially affecting market activity." [12]

Any purchase of stock in the open market (be it by AMFI, or by a shareholder such as Alabama Farm, which in 1973 and 1974 in fact purchased over $2.5

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[12] Stock repurchase programs are not novel forms of corporate transactions and, in fact, are quite common. The record in this case discloses that in the one year preceding March 1975, 25% of the companies listed on the New York Stock Exchange had engaged in repurchase programs, and that in a single month, March 1975, 113 companies announced their intention to embark upon such programs. [R.779-790; J.A. 471-484].

The Court of Appeals suggested that an inference of manipulation might be drawn from the fact that AMFI made small frequent purchases in the open market rather than large less frequent ones. However, this suggestion is inconsistent with the SEC's own proposed guidelines for corporate stock repurchase plans, which guidelines place specific limitations on the daily volume of securities which may be purchased. See Proposed Rule 13e-2, 17 C.F.R. § 240.13e-2; Securities Exchange Act Release No. 10539 (December 6, 1973), [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,600. The record demonstrates that, consistent with those guidelines, AMFI made small, frequent purchases rather than large, less frequent ones. [R.384-405; J.A. 372-393]. Inasmuch as Section 10(b) provides that a manipulative device is one inconsistent with the rules and regulations prescribed by the SEC, it is difficult to see how effectuating a stock repurchase program in accordance with SEC proposed guidelines can be a manipulative device. Of course, the directors' efforts in following those SEC guidelines also would seem to negate any possibility of finding the requisite specific intent or *scienter,* as is required under *Ernst & Ernst* v. *Hochfelder* for a violation of Section 10(b).

million of AMFI stock in the open market) would, in the words of the Court of Appeals, "tend either to increase the price of the stock or to avert a decline in price that might otherwise occur." [App. 14a]. Moreover, it cannot be seriously questioned that "every purchase by a corporation of its own stock serves to some extent to consolidate the control of existing management." *Rodman* v. *Grant Foundation,* 608 F.2d at 73. But under this Court's decision in *Santa Fe,* these facts do not transform such a standard stock transaction into a "manipulative device" within the meaning of Section 10(b) and Rule 10b-5. Otherwise, a decision by a company to repurchase its own shares on the open market would be virtually a *per se* violation of Section 10(b), while at the same time it would be proper for others—such as Alabama Farm in this case—to attempt to gain control of the corporation through the purchase of the same shares on the open market.[13]

Alabama Farm's amended complaint was most accurately described by Judge Skelton in his dissent:

> In my opinion, this case is much ado about nothing and borders on being frivolous. It is obvious that Alabama Farm evolved a plan to take control of AMFI one way or another. At first it sought to do this by buying 300,000 shares of AMFI's stock. When this plan failed to produce the desired results, it embarked on a course of conduct involving legal harassment, coercion and intimidation to gain control of AMFI. . . . As a part of its case, Alabama Farm is making demand

[13] Alabama Farm spent over $2.5 million for the purchase of AMFI stock on the open market because it believed AMFI stock was a good investment trading at a depressed market price. [R. 752, 802; J.A. 439, 502]. *See supra* note 3.

> on AMFI for $3,423,078 in damages without alleging any fact that would entitle it to even $1 in damages. However, the making of the claim in such a large amount is itself an harassment and an intimidation. It appears to me that AMFI has done no wrong and that Alabama Farm is the bad actor in this scenario. A reversal of this case would enable Alabama Farm to subject AMFI to more harassment and intimidation. I do not think we should allow our courts to be used for such purposes.

[App. 29a, n.1].

c. There was no federal claim.

In an effort to allege some wrong to AMFI, Alabama Farm did nothing more than contend that the repurchase program authorized by the Board was unwise, jeopardized capital and surplus, and involved unfortunate tax aspects and a waste of "statutory" corporate assets.[14] These are precisely the kinds of

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[14] Count I of Alabama Farm's amended complaint purports to be a derivative shareholder claim, and Alabama Farm therefore must be a fair and adequate representative of AMFI's entire shareholder body to be able to proceed with that claim. *See* Fed. R. Civ. P. 23.1. This requirement cannot be met. Alabama Farm itself purchased over 360,000 shares of AMFI stock on the open market and owns over 24 percent of AMFI's outstanding shares. [R.846; J.A. 554]. As Judge Skelton recognized, these purchases were part of a plan to take control of AMFI, as is this lawsuit. [App. 29a, n.1]. Thus, Alabama Farm's primary aim in this litigation is not protection of the shareholder body in recovery of damages for AMFI for the alleged wrongs of it directors, but some other personal objective. Accordingly, for this reason alone, Alabama Farm cannot fairly and adequately represent the interests of the other AMFI stockholders in this derivative action. *Rousse* v. *Tidelands Capital Corp.*, 438 F. Supp. 684, 688 (N.D. Ala. 1977). *See also Darrow* v. *Southdown, Inc.*, 574 F.2d 1333 (5th Cir.), *cert. denied*, 439 U.S. 984 (1978); *Nolen* v. *Shaw-Walker Co.*, 449 F.2d 506 (6th Cir. 1971); *Robinson* v. *Computer Servicenters, Inc.*, 75 F.R.D. 637 (N.D. Ala. 1976).

allegations of corporate mismanagement found insufficient in *Santa Fe* to make out a Rule 10b-5 violation. If, in light of disclosed terms and other material facts respecting a transaction, a shareholder believes that a waste of corporate assets or a breach of any other corporate fiduciary duty has occurred, the appropriate remedies under *Santa Fe* are those provided by the applicable state corporation law—*not* the federal securities laws. 430 U.S. at 478-480.[15]

By holding that a claim under Rule 10b-5 is made out by alleging corporate mismanagement coupled with the subjective personal motive to retain control, the Court of Appeals' decision permits a plaintiff with only a state law claim to obtain access to the federal courts and thereby further the type of "vexatious litigation" condemned by this Court in *Santa Fe* and *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740 (1975). Moreover, because the exploration of subjective intent as a threshold matter always will require the development of facts, discovery and trial will almost always be required and summary judgment will rarely be appropriate.[16] Thus, the Court of Appeals'

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[15] *See, e.g., Golub* v. *PPD Corp.*, 576 F.2d at 764; *Popkin* v. *Bishop*, 464 F.2d 714, 720 (2d Cir. 1972); *O'Neill* v. *Maytag*, 339 F.2d 764 (2d Cir. 1964); *Hoover* v. *Allen*, 241 F. Supp. 213, 229 (S.D.N.Y. 1965); *cf. Cort* v. *Ash*, 422 U.S. 66, 84-85 (1975).

[16] The large number of securities cases filed in the federal courts today portends a significant impact on the courts if virtually every case requires a full trial. While there were only 796 securities cases filed in the federal district courts in 1969, there were 2,378 cases filed five years later in 1974, 2,408 in 1975, 2,230 in 1976, 1,960 in 1977, 1,703 in 1978 and 1,589 in 1979. *See* Administrative Office of the United States Courts, 1974 Annual Report of the Director 205; Administrative Office of the United States Courts, 1979 Annual Report of the Director 60. This Court's decision in *Santa Fe* and other cases in the late 1970's have begun to decrease the swell-

decision permits precisely what Judge Skelton properly recognized as having been condemned by this Court in *Santa Fe*: "legal harassment, coercion and intimidation". [App. 29a, n.1]. *See also Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. at 740-743; *Hundahl* v. *United Benefit Life Ins. Co.*, 465 F. Supp. at 1363; *Tyco Laboratories, Inc.* v. *Kimball*, 444 F. Supp. at 298.

As this Court recognized in *Santa Fe*, the federal securities laws are intended to elicit the full disclosure of material facts. 430 U.S. at 474. Their primary goal is to assure that investors are provided with sufficient objective information to permit them to arrive at their own rational decisions. Requiring disclosure of subjective information, motive and intent of individual directors, and anticipated and speculative effects from transactions will rarely illuminate the facts already disclosed, but will only serve to confuse and mislead.[17] To make nondisclosure of subjective motivation actionable under Section 10(b) is inconsistent with the fundamental approach of the federal securities laws.

2. The Decision Of The Court Of Appeals Is Contrary To Decisions Of The United States Courts Of Appeals For The Seventh and Ninth Circuits.

On an issue which it found this Court had left open in *Santa Fe*, the Court of Appeals concluded that

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ing numbers of securities cases filed in the federal courts, but decisions such as that of the Court of Appeals in this case are likely substantially to reverse the trend.

[17] *See, e.g., Rodman* v. *Grant Foundation*, 608 F.2d at 71; *Stedman* v. *Storer*, 308 F.Supp. 881 (S.D.N.Y. 1969); Securities and Exchange Commission, *Report on Disclosure to Investors: A Reappraisal of Administrative Policies Under the '33 and '34 Acts* (Wheat Report) 10 (1969).

causation under Rule 10b-5 was established upon a showing that state law remedies would have been available if full disclosure of the motive and intent behind the stock repurchase plan had been made and that there was a prima facie case for relief; "it is not necessary to go further and prove that the state action would have been successful." [App. 19a]. In so holding, the Court of Appeals acknowledged that its decision directly conflicted with the decisions of the United States Court of Appeals for the Ninth Circuit in *Kidwell ex rel. Penfold* v. *Meikle,* 597 F.2d 1273 (9th Cir. 1979), and of the United States Court of Appeals for the Seventh Circuit in *Wright* v. *Heizer Corp.,* 560 F.2d 236 (7th Cir. 1977), *cert. denied,* 434 U.S. 1066 (1978).

In *Kidwell,* the Ninth Circuit expressly held that the mere fact that it is possible to state a claim under state law does not mean that the suit would have been successful and that success on the merits must be demonstrated. 597 F.2d at 1294. The Court stated that in light of *Santa Fe,* "we are foreclosed from holding that a minority shareholder can recover on the corporation's behalf under Rule 10b-5 simply because his or her state court complaint would have stated a cause of action." *Id.* Because of this Court's recognition in *Santa Fe* of the primacy of state law in remedying breaches of fiduciary duty and the lack of sufficient allegations of causation unless a plaintiff would have been able to assert a state law claim, the Court in *Kidwell* held that no relief is available under Rule 10b-5 unless it is demonstrated that a minority member would actually have succeeded in obtaining permanent injunctive relief or damages in the state law action.

Similarly, in *Wright* v. *Heizer Corp.*, 560 F.2d at 250, the Seventh Circuit analyzed the likelihood of success on the merits of the supposed state law claim and, only upon concluding that such claim would likely be successful, found the requisite causation under *Santa Fe. But see Goldberg* v. *Meridor,* 567 F.2d 209, 220-221 (2d Cir. 1977), *cert. denied,* 434 U.S. 1069 (1978).

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be granted.

March 1980

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APPENDIX A

ALABAMA FARM BUREAU MUTUAL CASUALTY COMPANY, INC., etc., Plaintiff-Appellant,

v.

AMERICAN FIDELITY LIFE INSURANCE COMPANY, etc., et al., Defendants-Appellees.

No. 77-1661.

United States Court of Appeals,
Fifth Circuit.

Nov. 15, 1979.

* * * * * * * * * * *

Appeal from the United States District Court for the Northern District of Florida.

Before SKELTON*, Senior Judge, HILL and RUBIN, Circuit Judges.

ALVIN B. RUBIN, Circuit Judge:

The plaintiffs in this stockholders' derivative action seek to recover for alleged violations of Rules 10b-5, 17 C.F.R. § 240.10b-5 (1976), and 14a-9, 17 C.F.R. § 240.14a-9 (1976) of the Securities and Exchange Commission, and corresponding provisions of the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78n(a), in the course of a stock repurchase program instituted by the defendants in 1974 and 1975. Finding certain facts to be undisputed, the district court granted summary judgment for the defendants on the basis that: (1) Rule 10b-5 was not violated because there was no "deception" of or "injury" to the plaintiffs in connection with the repurchase program;

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* SKELTON, Senior Judge of the United States Court of Claims, sitting by designation.

and (2) Rule 14a-9 was not violated because there were no significant misstatements or omissions in the proxy materials. The plaintiffs, who were never allowed to complete discovery in this matter, contest the court's conclusions and also assert that there was a genuine issue of material fact concerning whether the repurchase program was a "manipulative device" to boost the price of the corporation's stock and thereby protect management's control of the corporation. This is an issue that was raised in Alabama Farm's amended complaint but not directly considered by the district court. Despite the lengthy and able consideration of the issues by the trial judge on the motion for summary judgment, we find that there are genuine issues of material fact as to whether the stock repurchase program, as intended and carried out, was a manipulative device that injured the corporation by artifically boosting the price of the shares purchased by the corporation, and regarding whether the shareholders were "deceived" by the nondisclosure of this alleged scheme. It was, therefore, inappropriate, at least at the stage reached in the proceedings, to dispose of these portions of the case by summary judgment. With respect to the other charges, however, summary judgment was proper.

I. *Background*

American Fidelity [AMFI], a Florida life insurance company, issued stock to the public in the early 1960's at an average price of $25 per share. The stock, which is traded over the counter, reached a high of $45 per share on January 2, 1973; thereafter, during a general market decline the price fell until it was below $10 per share.

In September, 1973, a committee of AMFI's Board of Directors discussed repurchasing some of the company's stock. In October the committee voted to seek permission from the State of Florida and the SEC to repurchase up to $2,000,000 of its own stock on the open market.[1]

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[1] AMFI then had outstanding 1,812,735 shares of capital stock.

Then, beginning in October, 1973, Alabama Farm began to buy AMFI stock. By November, 1974, it had spent $2,530,000, and had acquired over 300,000 shares, approximately 20 percent of the then outstanding stock.

Shortly after Alabama Farm commenced its purchases of AMFI stock, the AMFI Board unanimously approved its committee's decision to seek authorization for a repurchase program. The program was launched with a press release on January 2, 1974, which also stated the Board's intention to carry out the purchases in a manner that would not unduly affect the market for the stock. The repurchase program was also described in AMFI's 1973 annual report, its 1974 mid-year report, and in additional press releases issued during the course of the program. In September, 1974, AMFI issued a press release announcing that, although the company had not completed the initial $2,000,000 stock repurchase program, it had increased the amount authorized for the program to $3,000,000. By February, 1975, AMFI had acquired a total of 314,535 shares at an average price of $8.41 per share.

In December, 1974, Alabama Farm filed this action in United States District Court for the Middle District of Florida charging AMFI and five of its directors with various violations of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.*

On March 24, 1975, the directors of AMFI mailed proxy materials to the company's stockholders in anticipation of the annual meeting to be held on April 22, 1975, at which the shareholders were to vote on resolutions to approve the past stock repurchases and an amendment to AMFI's certificate of incorporation reducing the number of directors from twelve to nine. In addition, the proxy materials sought votes on resolutions to approve amendments to AMFI's by-laws raising to three-quarters of the outstanding common stock the percentage of common stock necessary to remove a director without cause or to con-

stitute a quorum for any meeting at which election or removal of directors was considered. The proxy materials consisted of a notice of the annual meeting, a proxy statement, and AMFI's 1974 Annual Report, and they disclosed the existence and nature of plaintiff's present suit.

Alabama Farm responded by filing a second lawsuit in the United States District Court for the Middle District of Alabama seeking to enjoin the annual meeting on the grounds that the proxy materials contained misstatements and omissions in violation of Rule 14a-9 of the SEC. Thereafter, AMFI mailed to its stockholders a supplemental proxy statement informing them of the allegations contained in the recently filed lawsuit.

Alabama Farm then filed another action, this time in the Circuit Court for Escambia County in Pensacola, Florida. This action charged violations of Florida law governing the right of stockholders to inspect corporate records. After a hearing in April, 1975, the Florida district court denied the plaintiff's request for preliminary relief and entered an order enjoining further prosecution of the other suits and requiring Alabama Farm to file an amended complaint presenting all related claims.

In May, 1975, Alabama Farm filed the amended complaint now before this court. This pleading combined the charges made in all of the previously filed actions and added one additional state law claim. Count I charged that the individual defendants violated § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970), and rule 10b-5 of the SEC, 17 C.F.R. § 240.10b-5 (1976), by causing AMFI to launch a stock repurchase program resulting in the acquisition of over 300,000 shares of AMFI common stock during 1974. The individual defendants were alleged to have entered into a plan "to perpetuate and maintain their control of American Fidelity by manipulating the market in the Shares and artificially inflating the market price of the Shares by causing American Fidelity to repurchase Shares in order to discourage other shareholders

or nonshareholders from purchasing Shares or attempting to gain control of American Fidelity through the purchase of Shares." The complaint also alleged that these defendants deceived the shareholders in numerous ways in executing this scheme, and sought $3,423,078 in damages.

Count II charged that the individual defendants violated § 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a) (1970), and Rule 14a-9 of the SEC, 17 C.F.R. § 240.14a-9 (1976), by mailing proxy and supplemental proxy statements containing material misstatements and omissions. The plaintiff sought a declaratory judgment declaring all proxies obtained by use of the disputed proxy statements null and void and declaring the stockholders meeting of April 22, 1975, at which these proxies were voted, unlawful and all acts and resolutions of that meeting null and void; plaintiff also requested an order directing that a new stockholders' meeting be held and providing for the solicitation of new proxies. Counts III and IV asserted pendent state claims.

Alabama Farm made a number of attempts to exercise its discovery rights, but they were largely resisted by the defendants, and the district court did not order full discovery. For example, the defendants were served with interrogatories in January, 1975, but only one interrogatory was answered, and that was only after the district court had ordered a response.

In January, 1975, Alabama Farm also sought the production of minute books of AMFI's Executive Committee, Finance Committee and Board of Directors. These books were never produced, even though Alabama Farm offered to examine them at any location specified by the defendants so as not to disrupt AMFI's operations. The district court never heard or ruled on two motions Alabama Farm filed seeking to compel production of these records.

Alabama Farm fared little better with its attempts to obtain depositions. Of thirty-eight depositions scheduled

by it, only fifteen were actually taken, with five of those restricted to a motion to transfer. The defendants filed fourteen motions for protective orders with respect to scheduled depositions. Alabama Farm found it necessary to file fifteen motions to compel answers to questions that witnesses refused to answer. The district court never heard or ruled on any of these motions.

On December 22, 1975, the district court held a hearing on the defendants' motion to dismiss, or in the alternative for summary judgment, and on the plaintiff's motion for partial summary judgment on one of the state law claims. A request for a stay of discovery was included in the motion for summary judgment, and was granted on February 13, 1976, by a different judge than the one who heard that motion. Because the judge who was considering the summary judgment motion had indicated that a ruling would shortly be issued, the second judge ordered Alabama Farm to stay discovery until ten days after the ruling on the defendants' motion to dismiss or for summary judgment. In fact, though, the ruling on the summary judgment motion was not released until a year later; on February 11, 1977, the court granted summary judgment for the defendants on Counts 1 and 2 and dismissed the state law claims without prejudice. In the interim, Alabama Farm was unsuccessful in its attempts to have the stay dissolved.[2]

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[2] We recognize that these matters arose at times when the district court was heavily burdened with demanding criminal trials and with the exigencies of the Speedy Trial Act; that the district had an inadequate number of judges to meet the demands of its trial calendar; and that the judge who had initially handled the case and later heard the motion for summary judgment had, in the meanwhile, been appointed to this court, and was, therefore, by that time attempting to carry an almost superhuman double load. Our observations in the opinion are, therefore, in no way critical of the intensive efforts that were obviously made by the trial judge to consider fully the issues in this complex case while under multiple pressures.

II. *The Alleged Violations of § 10(b) and Rule 10b-5*

Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), makes unlawful the use of "any manipulative or deceptive device or contrivance" in contravention of SEC rules. Rule 10b-5, promulgated by the SEC under § 10(b), prohibits, in addition to nondisclosure and misrepresentation, any "artifice to defraud" or any act "which operates or would operate as a fraud or deceit." A cause of action lies under Rule 10b-5 "only if the conduct alleged can be fairly viewed as 'manipulative or deceptive' within the meaning of the statute." *Santa Fe Industries, Inc. v. Green,* 1977, 430 U.S. 462, 473-74, 97 S.Ct. 1292, 1301, 51 L.Ed.2d 480, 492. A breach of fiduciary duty by majority stockholders or corporate officers without any manipulation, deception, misrepresentation or nondisclosure violates neither the statute nor Rule 10b-5; such a violation is actionable solely under state law. *Id.*

In this action Alabama Farm alleged that the individual defendants' conduct was fraudulent because they did not disclose to the Board or the shareholders either their real motive for adopting the repurchase program, which was allegedly to retain their position of control over AMFI,[3]

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[3] In a related allegation, Alabama Farm asserted that the defendants failed to disclose their possible "conflict of interest." The conflict of interest that allegedly should have been disclosed by them was their interest in maintaining control of the corporation.

Corporate directors and officers of a corporation are under a duty to disclose their interests in other parties that engage in transactions with the corporation. The existence of such interests in a party to a securities transaction with the corporation is "material" information to the corporation's shareholders or directors; thus, the failure to disclose such information is "deceptive" within the meaning of Rule 10b-5. *See Kidwell v. Meikle,* 9 Cir. 1979, 597 F.2d 1273, 1293; *Swanson v. American Consumer Indus., Inc.,* 7 Cir. 1969, 415 F.2d 1326, 1330. *Cf. TSC Indus., Inc. v. Northway,*

or the effect of the program on the company's statutory capital and surplus,[4] which under Florida law could adversely affect its ability to write new insurance.[5] The dis-

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Inc., 1976, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (§ 14(a) and Rule 14a-9 violation).

In this case, however, it is not alleged that the directors had a conflicting interest in another party to a corporate transaction. It is also not alleged that the ownership interests of the directors of AMFI were not disclosed; they were, of course, public information. Thus, any conflict of interest was readily apparent, *see Frigitemp Corp. v. Financial Dynamics Fund, Inc.*, 2 Cir. 1975, 524 F.2d 275, 282, or a matter of "characterization" of the purpose and effect of the transaction rather than of "fact." *See Goldberg v. Meridor*, 2 Cir. 1977, 567 F.2d 209, 218, n.8, *cert. denied*, 1978, 434 U.S. 1069, 98 S.Ct. 1249, 55 L.Ed.2d 771.

[4] Florida statutes specify those assets that the Florida Department of Insurance will consider in determining an insurer's financial status; these assets are called "admitted assets." Under this "statutory accounting," treasury stock (previously, issued stock owned by the corporation that issued it) is a "non-admitted asset", an asset that is not counted in determining the insurer's financial status. Fla.Stat. § 625-031(3). Thus, if an insurer purchases its own stock, or any other non-admitted asset with cash (an "admitted asset"), its statutory capital or surplus is reduced because an asset carried on its statutory accounting balance sheet is replaced by an asset that cannot be carried on this balance sheet.

[5] Florida law mandates that insurers maintain at least a specified minimum statutory capital and surplus. Fla.Stat. § 624.409. Should an insurer's statutory capital and surplus fall below these minimum amounts, the Department of Insurance can declare the insurer insolvent and place it in receivership. Fla.Stat. § 631.051. Problems may also arise even before this minimum level is reached.

If statutory capital and surplus is depleted to the point that the corporation is in danger of falling below the minimum levels established by statute, then the company will be rendered more vulnerable to investment losses. For example, under statutory accounting all the costs of writing a new policy must be accounted for in the year incurred, rather than amortized over the life of the policy. If an insurer has an unprofitable year, these expenses will deplete statutory capital and surplus, and if the insurer's

trict court found that the undisputed facts showed that the company had adequately disclosed the existence, size and effect of the program, and it held that Rule 10b-5 does not require corporate directors and officers to disclose their subjective motivation in adopting a stock repurchase program.

The burden is on the party seeking summary judgment to show that there is no genuine issue of material fact. The "party opposing the motion is to be given the benefit of all reasonable doubt in determining whether a genuine factual issue exists." *Kellerman v. Askew,* 5 Cir. 1976, 541 F.2d 1089, 1092. In considering a summary judgment motion, the inferences most favorable to the party opposing the motion will be drawn. *Boazman v. Economics Lab., Inc.,* 5 Cir. 1976, 537 F.2d 210, 214. Such inferences may create disputes regarding basic facts or regarding facts to be inferred from such facts.

"In applying the basic principles the factor of access to proof must, however, be seriously considered in ruling on a defendant's motion for summary judgment, particularly in [a stockholder's derivative action] where plaintiff's proof must come mainly from sources largely within the control of the defendants and from the mouths of the alleged wrongdoers." 6 *Moore's Federal Practice* ¶ 56.17 [60] at 56-1065 (1976 ed.) (footnotes omitted). Summary judgment should not, therefore, ordinarily be granted be-

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statutory capital is already at a low level, it may have to limit its writing of new insurance. Moreover, investment losses are charged directly to statutory capital and surplus; if substantial, they may force an insurer that has only the minimum level of capital and surplus to seek reinsurance of all or a substantial portion of one of its lines of insurance. This is disadvantageous to the insurer because its profits must be reduced to allow profit to the reinsurer, it must pay the reinsurer to administer the business, and it will incur additional administrative costs in reporting to the reinsurer.

fore discovery has been completed. *Goldberg v. Meridor,* 2 Cir. 1977, 567 F.2d 209, 213, *cert. denied,* 1978, 434 U.S. 1069, 98 S.Ct. 1249, 55 L.Ed.2d 771. *See also Schoenbaum v. Firstbrook,* 2 Cir. en banc 1968, 405 F.2d 215, 218 *cert. denied sub nom. Manley v. Schoenbaum,* 1969, 395 U.S. 906, 89 S.Ct. 1747, 23 L.Ed.2d 219. " 'Cases in which the underlying issue is one of motivation, intent, or some other subjective fact are particularly inappropriate for summary judgment, as are those in which the issues turn on the credibility of the affiants.' " *Slavin v. Curry,* 5 Cir. 1978, 574 F.2d 1256, 1267, quoting *Conrad v. Delta Air Lines, Inc.,* 7 Cir. 1974, 494 F.2d 914, 918.

Summary judgment may be improper, even though the basic facts are undisputed, if the ultimate facts in question are to be inferred from them, and the parties disagree regarding the permissible inferences that can be drawn from the basic facts. *Winter v. Highlands,* 5 Cir. 1978, 569 F.2d 297, 299. " '[T]he choice between permissible inferences is for the trier of facts.' " *Nunez v. Superior Oil Co.,* 5 Cir. 1978, 572 F.2d 1119, 1124, quoting, *Walker v. U.S. Gypsum Co.,* 5 Cir. 1959, 270 F.2d 857, 862, *cert. denied,* 1960, 363 U.S. 805, 80 S.Ct. 1240, 4 L.Ed.2d 1148. Where a jury is called for, the litigants are entitled to have the jury choose between conflicting inferences from basic facts. *Nunez, supra,* 572 F.2d at 1124. However, where the judge is the trier of fact, as was the case here, he may be in a position to draw inferences without resort to the expense of trial, unless there is an issue of witness credibility. *See id.* at 1124-25.

Applying these criteria, we find that the defendants did succeed in establishing the absence of any genuine issue of material fact related to the allegations we have just discussed. Although the plaintiff did not have an opportunity to complete discovery, some facts were so well established that it is not conceivable that they would ever be disputed, and no contention is made that countervailing evidence might be adduced regarding these points if further deposi-

tions or document examination were permitted. Thus, the fact that press releases were issued and their contents; the identity and contents of proxy statements; and certain other evidentiary facts established by documents are, indeed, undisputed. Considering this uncontroverted evidence, the district court correctly concluded that the plaintiff's allegations were either not sufficient to establish the requisite element of deception, even if proved, or were conclusively refuted.

Alabama Farm's thesis that the failure of a controlling stockholder or corporate official to disclose his motives in entering a transaction constitutes the "deception" requisite for a 10b-5 violation is not supported by the cases cited to us, e. g. *SEC v. Blatt,* 5 Cir. 1978, 583 F.2d 1325; *Goldberg, supra; Schoenbaum v. Firstbrook, supra; Subin v. Goldsmith,* 2 Cir. 1955, 224 F.2d 753, *cert. denied,* 350 U.S. 883, 76 S.Ct. 136, 100 L.Ed. 779; and *Fogelson v. American Woolen Co.,* 2 Cir. 1948, 170 F.2d 660. Nor has our own research disclosed any such circuit decisions. However, there is authority to the contrary. *Golub v. PPD Corp.,* 8 Cir. 1978, 576 F.2d 759, 765; *Joyce v. Joyce Beverages, Inc.,* 2 Cir. 1978, 571 F.2d 703, *cert. denied,* 1978, 437 U.S. 905, 98 S.Ct. 3092, 57 L.Ed.2d 1135. *See also O'Neill v. Maytag,* 2 Cir. 1964, 339 F.2d 764, 767; *see generally,* A. Fleischer, *Federal Corporation Law; An Assessment,* 78 Harv.L.Rev. 1146, 1166 (1965). *But see* A. Jacobs, 5A Securities Law Series, The Impact of Rule 10b-5, § 121.01 at 5-87 (1977). We believe that the position taken by these courts is sound. Section 10(b) and Rule 10b-5 were promulgated to prevent fraudulent practices in securities trading and trading on inside information. *See, e.g., Santa Fe Industries, supra.* They were not intended to require, under normal circumstances, the disclosure of an individual's motives or subjective beliefs, or his deductions reached from publicly available information.

In *Goldberg, supra,* cited by the appellants, numerous material facts, including the effect of an exchange of assets

for shares on the operating position of one of the corporate parties, were misrepresented. The defendants did not simply fail to disclose the purpose of the transaction; they falsely stated that the party whose shares were issued for an inadequate consideration was to become the principal operating corporate subsidiary in the resulting multi-corporate structure, when in actuality the transaction would seal its doom. Thus, the requisite "deception" was found on the basis of more than mere nondisclosure of the motive for the transaction. In addition, the court noted that it did "not mean to suggest that § 10(b) or Rule 10b-5 requires insiders to characterize conflict of interest transactions with pejorative nouns or adjectives." 567 F.2d at 218 n.8.

Of the other cases cited by the appellants, both *Subin, supra,* and *Fogelson, supra,* were diversity cases that involved alleged abuse of discretion by directors amounting to corporate waste. The motives of the directors in approving certain transactions were relevant to whether the directors had exercised "honest business judgment." Neither § 10(b) nor Rule 10b-5 was involved, and the cases clearly did not hold that directors must disclose their motives for approving corporate undertakings involving transactions in securities. In *Schoenbaum, supra,* and *Blatt, supra,* the issue was whether certain securities were purchased on the basis of undisclosed inside information concerning the value of the stock purchased. Neither case was concerned with the question of whether the defendants should have disclosed their "motive" in entering into the transaction. Although in *Schoenbaum* the court noted that "motive" may be important in many stockholders' derivative actions, it did not hold that disclosure of "motive," apart from material "facts", is required in securities transactions.

When the nature and scope of a transaction are clear, it is not necessary for the corporate instigators to characterize the various effects of the transaction as favorable or unfavorable or to evaluate its overall effect; such charac-

terization is a matter of judgment, not fact. *See Golub v. PPD, supra.* However, it is necessary for the impact of a transaction to be described factually to the extent that such information would be significant to a reasonable, disinterested director, *Goldberg, supra,* at 219, or shareholder, *Kidwell v. Meikle,* 9 Cir. 1979, 597 F.2d 1273, 1293 n.10; *Joyce, supra,* 571 F.2d at 706-07 & n.6. *See Wright v. Heizer Corp.,* 7 Cir. 1977, 560 F.2d 236, 247, *cert. denied,* 1978, 434 U.S. 1066 98 S.Ct. 1243, 55 L.Ed.2d 767 (if shareholder approval not required, disclosure to board of directors sufficient if majority is disinterested; otherwise, disclosure to shareholders is required). *Cf. TSC Industries, Inc. v. Northway, Inc.,* 1976, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed. 2d 757 (materiality standard for action arising under § 14(a) and Rule 14a-9).

In this case, as the district court found, the size and scope of the stock repurchase plan were adequately disclosed.[6] The initial press release also pointed out that one effect of the program would be to decrease the firm's "capital" and "surplus". It was unnecessary for AMFI to outline any or all of the possible dangers that could be posed by a decrease in statutory capital and surplus; the disclosure that they would be decreased was adequate.

In addition to the allegations discussed above, however, Alabama Farm alleged that the repurchase plan was a part of a "plan or scheme to perpetuate and maintain . . . control of American Fidelity by manipulating the market in [AMFI's] Shares and artificially inflating the market price of the Shares . . . in order to discourage other shareholders or nonshareholders from purchasing Shares or attempting

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[6] The defendants presented evidence of a number of disclosures made by AMFI, including press releases issued on January 2, 1974, February 28, 1974, April 24, 1974, and September 24, 1974, and statements in AMFI's 1973 annual report and in a mid-year report mailed to stockholders on August 1, 1974. Alabama Farm has never disputed the contents of these disclosures, or the fact that they were made.

to gain control of" AMFI. This plan was alleged to have damaged AMFI "for the sole personal benefit" of the defendants. Alabama Farm also asserted that, in connection with this scheme, the defendants omitted to disclose the inflationary effect AMFI's repurchases would have on the market price of its outstanding shares. In granting summary judgment the district court discussed neither this alleged manipulative device nor the significance of the alleged omission.

Of course, any person having rudimentary knowledge of securities trading would realize that a course of purchasing stock would tend either to increase the price of the stock or to avert a decline in price that might otherwise occur. The allegation would not, therefore, even state a claim for which relief might be granted if it contended only that the defendants failed to reveal the obvious or the well-known. However, read as a whole, the complaint, as quoted above, asserts a scheme artificially to manipulate the market and artificially (that is, beyond the operation of normal market factors) to inflate prices.

The defendants contend that the manipulation alleged is not within the scope of Rule 10b-5, because it is not the traditional type of manipulation at which Rule 10b-5 was directed. In addition, they assert that, for this type of manipulative scheme to fall within the prohibition of Rule 10b-5, nondisclosure is essential, and they argue that the undisputed facts show that there was adequate disclosure. Furthermore, they contend that the injury, if any, was to those who found it more difficult to purchase shares, not to the corporation, which purchased shares at what they claim to have been their fair market value, and that Alabama Farm, as a derivative plaintiff,[7] had no standing to assert

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[7] Without discussion of the kind of class or the kind of class action involved, and without notice to the class, the district court certified the case as a class action in the following terms:

1. This action is properly maintainable as a class action. The questions of law or fact common to the members of the class

injury to persons other than the corporation. These contentions are not enough to shore up the summary disposition of Alabama Farm's claims.

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predominate over questions affecting only individual members; in fact, the record does not suggest the existence of substantial questions affecting only individual members. The plaintiff is fully able to represent the class and to maintain this litigation. Furthermore, the maintenance of this action will render unnecessary, if not preclude, a multiplicity of suits by members of the class in other forums on claims arising out of the facts underlying the plaintiff's allegations in this case.

By the nature of this action this could be no more than the certification of a class of stockholders to whose ultimate benefit the derivative action might in part inure. The certification could not embrace the sellers of stock, and AMFI and American Fidelity were the only buyers. The district judge's comments during the hearing on the question of class certification are consistent with our conclusion that the class referred to in his order was a class of shareholders:

THE COURT: And I think I'll go ahead and find an appropriate class, but I think the notice to the class is something that the transferee judge ought to make.

MR. WILBUR: But you are maintaining a finding for the class?

THE COURT: You are in here representing an insurance company. You are fully liable to represent all the stockholders. Do you have any objection to the plaintiffs' insurance company as a proper representative of the class of stockholders?

* * * * * *

THE COURT: Well, I know that, but I think—they are entitled to a clear declaration of a class. I think——

MR. BROWER: I think there will be no problem about prompt and expeditious procedures in this case. That goes into the class action as well, Your Honor.

THE COURT: But you do not dispute the ability of the plaintiffs' insurance company to finance this lawsuit?

MR. BROWER: If it's a question——

THE COURT: And to represent the stockholders per se?

MR. BROWER: If it is a question of finance, I do not dispute the question of finance.

As the defendants note, the Supreme Court has cautioned that "'[m]anipulation' is 'virtually a term of art when used in connection with securities markets.'" *Santa Fe Industries, supra,* 430 U.S. at 476, 97 S.Ct. at 1302, 51 L.Ed.2d at 493, quoting *Ernst & Ernst v. Hochfelder,* 1976, 425 U.S. 185, 199, 96 S.Ct. 1375, 1384, 47 L.Ed.2d 668, 680. "The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by *artificially* affecting market activity." (Emphasis supplied.) *Santa Fe Industries, supra,* 430 U.S. at 476, 97 S.Ct. at 1302, 51 L.Ed2d at 493-494. "Manipulation" has referred, in general, to devices used to induce investment in a company's stock, not to devices implemented to discourage such investment.

Conduct designed to deter investment is within the scope of Rule 10b-5 when it acts as a deceit or works as a fraud on a corporation or those who have invested in its stock. *Cf.* A. Jacobs, 5A Securities Law Series. The Impact of Rule 10b-5 § 139.05[a] and [f] at 6-30, 6-37—6-39 (1977). Such conduct falls within the scope of the literal language of § 10(b) and Rule 10b-5 and is consistent with the congressional intent to proscribe intentional or willful conduct designed to deceive or defraud investors. As the Supreme Court has noted, § 10(b) is "described rightly as a 'catchall' clause to enable the Commission 'to deal with new manipulative [or cunning] devices.'" [8] *Ernst & Ernst, supra,* 425

THE COURT: Or to represent the stockholders?

MR. BROWER: There have been other reasons why they are not the proper representatives of the stockholders of this company.

THE COURT: Well, that is something you will have to bring up later.

[8] The Senate indicated in its report that § 10(b) was directed "at those manipulative and deceptive practices which have been demonstrated to fulfill no useful function." S.Rep. No. 792, 73d Cong., 2d Sess., 6 (1934). A corporation's purchase of its shares at artificially inflated prices would not appear to serve a useful purpose.

U.S. at 203, 96 S.Ct. at 1385, 47 L.Ed.2d at 682, quoting Hearings on H.R.7852 and H.R.8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 115 (1934) (remarks of Thomas G. Corcoran, a spokesman for the drafters of the provision that was to become § 10(b)). *See* A. Jacobs, 5A Securities Law Series: The Impact of Rule 10b-5 § 138.01 at 6-2—6-3. In addition, because this is "remedial" legislation, *SEC v. Capital Gains Research Bureau,* 1963, 375 U.S. 180, 195, 84 S.Ct. 275, 284, 11 L.Ed.2d 237, 248, it must be construed " 'not technically and restrictively, but flexibly to effectuate its remedial purposes.' " *Affiliated Ute Citizens v. United States,* 1972, 406 U.S. 128, 151, 92 S.Ct. 1456, 1471, 31 L.Ed.2d 741, 760, quoting *SEC v. Capital Gains Research Bureau, supra,* 375 U.S. at 186, 84 S.Ct. at 280, 11 L.Ed.2d at 243. *See also A. T. Brod & Co. v. Perlow,* 2 Cir. 1967, 375 F.2d 393, 396.

Even if this alleged scheme was not a "manipulative" device within the meaning of Rule 10b-5, Alabama Farm adequately alleged "deception" in the defendants' failure to disclose that the repurchase plan was to be carried out in a manner that would artificially inflate the price of AMFI's stock in order to benefit the defendants personally and in their misrepresentation in the initial press release that the purchases would be carried out in a manner that would not unduly affect the market. The fact that, if this manipulative scheme was intended, some or all of the directors were aware of it, does not negate the element of deception.[9] The requisite "deception" is provided if the disinterested directors or shareholders are misled, because they are fairly viewed as standing in the place of the cor-

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[9] A few courts initially suggested that the knowledge of officers and directors would be attributed to the corporation, thereby negating the element of deception. *See generally* A. Bromberg, 1 Securities Law—Fraud: SEC Rule 10b-5 § 4.7(542) (1977) (hereinafter cited as *Bromberg*) and cases cited therein. This "strict view" has generally been abandoned. *See Bromberg,* § 4.7(542) at 84.55.

porate entity under these circumstances. *See, e.g., Kidwell, supra,* 597 F.2d at 1293; *Goldberg, supra,* 567 F.2d at 215-19; *Wright v. Heizer Corp., supra,* 560 F.2d at 247, 249; *Shell v. Hensley,* 5 Cir. 1970, 430 F.2d 819, 827; *Rekant v. Desser,* 5 Cir. 1970, 425 F.2d 872, 879-82; *Pappas v. Moss,* 3 Cir. 1968, 393 F.2d 865, 869; *see generally,* Note, *Suits for Breach of Fiduciary Duty Under Rule 10b-5 After Santa Fe Industries, Inc. v. Green,* 91 Harv.L.Rev. 1874, 1875, 1881-84 (1978); 1 A. Bromberg, *Securities Law: Fraud* § 4.7 (542) to (544) (1977).

In *Santa Fe Industries, supra,* minority shareholders were "frozen out" of a corporate subsidiary in which they owned shares through a procedure under Delaware corporation law known as the "short-form" merger. This device allows a parent company that owns 90 percent or more of its subsidiary's shares to force the minority to sell their shares. The only remedy available to the minority shareholders if they consider the price offered inadequate is to seek appraisal of the shares in a state court. The minority shareholders brought a 10b-5 action alleging that the majority had breached their fiduciary duty to the minority under state law. In light of the language of the statute, the fact that Congress has left the regulation of shareholder-management relations largely to the states, and the problems posed by overlapping and possibly inconsistent federal and state laws in this area, the Court held that there is no implied cause of action under § 10(b) or Rule 10b-5 for a breach of state law fiduciary duty absent "deception" or "manipulation." 430 U.S. at 477-80, 97 S.Ct. at 1303-04, 51 L.Ed.2d at 494-496.

Applying this test, it noted that although the minority shareholders alleged that the majority stockholder's failure to give advance notice of the merger was a material nondisclosure, if such disclosure had been given, the minority would still have been able to seek relief only through appraisal in the state courts. Therefore, it concluded that this was not a material nondisclosure within the meaning of

§ 10(b) or Rule 10b-5. Because no deception of manipulation was shown, the Court held that the suit failed.

Santa Fe Industries leaves open the question whether, in addition to showing that he could have brought a suit in the state court, a shareholder must show that he would have prevailed in the state court action. *See generally* Note, *Suits for Breach of Fiduciary Duty Under Rule 10b-5 After Santa Fe Industries, Inc. v. Green,* 91 Harv.L.Rev. 1874, 1893-98. The Ninth Circuit has held that he must prove both, *Kidwell, supra,* 597 F.2d at 1294, and the Seventh Circuit appears to have taken a similar approach. *Wright v. Heizer Corp., supra,* 560 F.2d at 250-51. However, in *Goldberg, supra,* the Second Circuit refused to dismiss a claim where a state suit would have been possible, even though there was no allegation that the shareholders would have succeeded. The court did not inquire further into the shareholder's likelihood of success in such a state action.

We hold that all that is required to establish 10b-5 liability is a showing that state law remedies were available and that the facts shown make out a prima facie case for relief; it is not necessary to go further and prove that the state action would have been successful. On the one hand, to require merely the establishment of a theoretical legal claim under state law would be to predicate relief on a hypothetical basis. On the other, to require proof of victory would be in effect to exact the equivalent of a trial of the state claim. The rule that appears to us to be both desirable and practicable steers between Scylla and Charybdis: the plaintiff must show that there is at least a reasonable basis for state relief, but need not prove that the state suit would in fact have been successful.

We turn then to Florida law to apply this standard. Florida law does not provide a state appraisal remedy for shareholders dissenting from their corporation's repur-

chase of its shares,[10] nor does it restrict relief for misconduct in connection with such repurchases to that remedy, unlike the Deleware provisions that governed the merger in *Sante Fe Industries, supra.* Under Florida law, the shareholders or directors could have sought injunctive relief to block the stock-purchase plan if they had been aware of this scheme.[11] Thus, there would have been a reasonable basis to seek relief in state court.

A reasonably prudent stockholder or disinterested director, in making an intelligent decision whether to take steps to stop the repurchase program, would certainly have considered it significant whether management had embarked on a program of maintaining control at the cost of inflating stock prices. Such a tactic might temporarily run up stock prices, but in the long run it might also lead to a complete

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[10] Florida law provides an appraisal remedy for shareholders who dissent from a corporate merger, 18 West's F.S.A. § 607.247 (1977), but there is no such provision applicable to those who dissent from a repurchase of shares.

[11] Under Florida law, directors are quasi-fiduciaries, and are liable to the corporation or the shareholders for breaches of their trust. *E. g., Orlando Orange Groves Co. v. Hale,* 1933, 107 Fla. 304, 144 So. 674, 677; *B. & J. Holding Corp. v. Weiss,* Fla.App. 1977, 353 So.2d 141, 143. " 'Equity will protect a minority shareholder against conduct of the directors which is in breach of the trust confided in them and injurous to the stockholders . . .' " *Orlando Orange Groves, supra,* 144 So. at 677. The Florida courts may enjoin a director from engaging in acts that are unfair to minority shareholders. *See id.* (temporary injunction against misuse of corporate assets); *Ridgeland Development Co. v. Bundy,* 1933, 108 Fla. 246, 146 So. 379 (suit to enjoin directors from cancelling their obligations to pay stock subscriptions and from disposing of corporate assets held sufficient against motion to dismiss); *Belcher v. Schilling,* Fla.App. 1975, 309 So.2d 32 (shareholder derivative action seeking temporary and permanent injunctive relief and mandamus to invalidate proxies directors allegedly obtained from other shareholders by knowingly misleading them held sufficient to state cause of action). *See also Jacobs v. Adams,* 5 Cir. 1979, 601 F.2d 176.

corporate disaster either in terms of management ability or financial weakness. The alleged omission or misrepresentation, therefore, involved material information, *see Santa Fe Industries, supra,* 430 U.S. at 474 n.14, 97 S.Ct. at 1301, 51 L.Ed.2d at 492; *Kidwell, supra,* 597 F.2d at 1239 & n.10; *Goldberg, supra,* 567 F.2d at 219: *cf. TSC Industries, supra,* 426 U.S. at 449, 96 S.Ct. at 2133, 48 L.Ed.2d at 766 (materiality standard in action involving § 14(a) and Rule 14a-9), and *Santa Fe Industries* is distinguishable because in this case there was not full disclosure, manipulation and deception were adequately alleged, and the shareholders might have been able to obtain equitable relief blocking the transaction in state court. Absent full discovery, and perhaps eventual trial, we cannot determine whether deception can be proved.

Alabama Farm's allegation that the defendants caused the corporation to purchase its shares at artificially inflated prices also adequately asserts the "injury" required for a 10b-5 violation. While current market price is commonly considered a fair measure of value, *see, e.g., Kaufmann v. Lawrence,* S.D.N.Y.1974, 386 F.Supp. 12, *aff'd,* 2 Cir. 1975, 514 F.2d 283, this cannot be the measure if the market is distorted by the manipulation. If market price were always considered a fair measure of value, most, if not all, manipulative devices would not be subject to sanction under Rule 10b-5. Manipulation may affect the price even of stock listed on the New York Stock Exchange and traded in large volume; it obviously could have greater impact on the stock of a company traded only over the counter and in relatively small quantities.

Therefore, the argument that AMFI was paying only the market price is plausible, but sophistic. AMFI's stock was traded only over the counter. The number of transactions were, apparently, few. AMFI was certainly the largest buyer in the market and perhaps, save for Alabama Farm, the only one. What AMFI was willing to pay may have

established the market. What would have been a fair price, or the market price absent the influence of AMFI on the market, is, at this time, only a matter of conjecture. It is at this stage, too, a non-sequitur to conclude that, because the stock at one time sold at $45, purchases executed later at an average cost of $8.41 were not at an inflated price. It is conceivable that, but for the alleged scheme, the price at the later date might have averaged $2.00.

It is the vice of the summary judgment at this stage that it was granted before all the disputed facts were known.

The defendants have thus far failed to meet their burden of establishing the absence of any genuine issue of material fact regarding their alleged scheme to inflate the price of AMFI shares. Even though Alabama Farm did not have a full opportunity to conduct discovery, it did uncover some circumstantial evidence suggesting either a scheme to purchase AMFI stock at any price or purchases without regard for the relation of the price paid to the stock's value or to the effect of that price on the market. For example, there was evidence of steady buying by AMFI,[12] and documents obtained from AMFI might lead a trier of fact to conclude that in some instances inflated prices were paid.[13]

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[12] After its first two purchases in January, 1974, AMFI steadily bought over the course of four months, failing to make purchases on only 8 days that the market was open. AMFI might well have been following a policy of steady purchases in small amounts in order to avoid disrupting the market for its stock, and to keep the price down; if so, its actions would be blameless. *See* 3 L. Loss, Securities Regulation at 1551. However, its actions are also susceptible to the inference that it was attempting to support the market over a longer time period than would be the case if it made less frequent, but larger, purchases.

[13] When AMFI began its stock repurchase plan in January, 1974, its first two purchases were made at a price of approximately $6.73 per share. After AMFI's steady purchases during the first four months of 1974, the price of AMFI stock rose, and thereafter AMFI made no purchase below $7.25 per share. In one in-

In addition, the stock repurchase program apparently did cause a serious deterioration of AMFI's policyholder surplus, prompting the Florida Department of Insurance to write AMFI on February 21, 1975 directing it to cease its repurchases. This deterioration in its policyholder surplus occurred at a time, late 1974, when AMFI was also experiencing investment reverses that could have resulted in substantial charges to its statutory capital and surplus if the Department of Florida had deemed the investments to be nonadmitted assets.[14] Such charges, at least in conjunction with the depletion in statutory capital caused by the stock repurchase program, might have drastically affected AMFI's ability to write new business.[15] The timing of the repurchase program and the tax incurred as a result of the program's implementation are also circumstantial evidence

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stance AMFI apparently paid as much as $30.12 per share, as its documents show an expenditure of $69,300 for 2,300 shares.

AMFI made no purchases during May, June and July, but actively resumed them in August, 1974. During August the stock was purchased for an average of $8.50 per share, but AMFI's records indicate that it purchased some shares at a price of $22.19 per share and others at a price of $14.18 per share.

[14] AMFI's 10-K filed with the Securities and Exchange Commission in 1974 revealed that one of the projects to which AMFI had made a $3,000,000 mortgage loan was in Chapter X proceedings and AMFI was not then accruing interest on the loan. Additionally, the 10-K indicated that AMFI had received a letter from the Florida Department of Insurance dated March 7, 1975 requesting a meeting with AMFI officials because, as of December 31, 1974, AMFI had $8,700,000 worth of mortgage loans outstanding upon which interest was overdue more than three months. A meeting was mandated because the value of these mortgages exceeded AMFI's current surplus. If the Department had treated the mortgage loans as non-admitted assets, it could have resulted in the statutory insolvency of AMFI; at the end of 1974 the statutory capital and surplus of AMFI totaled only $3,690,996, approximately 42% of the value of the mortgage loans in default.

[15] See footnote 5, *supra*.

from which it might be inferred that the defendants were inflating the price of AMFI stock in order to maintain their control over the corporation or were acting in the knowledge that such inflation would be the necessary result of their conduct. The program was undertaken at the same time as Alabama Farm was making substantial purchases of AMFI stock, and caused AMFI to incur $695,142 in federal income taxes in 1974 alone.[16] Because the inferences to be drawn from these facts are disputed, we cannot determine whether the evidence would support the thesis that there was a scheme to maintain corporate control at any price or that the effect of the repurchase plan, as carried out, was to inflate the price of the stock.

Although the defendants presented affidavits and excerpts from the minutes of meetings of AMFI's Board of Directors to support their assertion that the repurchase program was undertaken simply as a good investment, this was insufficient to eliminate a genuine issue of fact as to the scope and predictable effect of the repurchase program. *See generally* 3 L. Loss, Securities Regulation at 1552-53 (2d ed. 1961). These issues involve subjective fac-

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[16] Under the provisions of the Life Insurance Company Income Tax Act of 1959, Pub.L. 86-69, June 25, 1959, 73 Stat. 112, as amended, an insurance company may place a designated amount of earnings in a "Policyholders' Surplus Account" and avoid paying tax on this income. When distributions are made from this account, such as when an insurer purchases its own shares, the amount of the distribution is added to taxable income for that year, resulting, in effect, in the payment of income taxes on old earnings at corporate income tax rates. *See* 26 U.S.C. §§ 801 *et seq.*

A life insurance company may accumulate income in this account over a number of years. Alabama Farm introduced the affidavit of a witness who testified that most companies strenuously avoid a distribution and resultant taxation on these earnings. In repurchasing its shares, however, AMFI distributed the entire balance of its Policyholders' Surplus Account, voluntarily triggering federal income taxes in one year of $695,142. Purchases made by AMFI in 1975 will receive similar tax treatment.

tors such as the knowledge available to the defendants and their intentions in pursuing the program; determination of these issues may require a full trial to enable the trier of fact to observe the demeanor of the witnesses, particularly during cross-examination *see, Slavin v. Curry, supra;* in conjunction with the genuine issue of fact presented concerning whether the corporation was "injured" by the alleged scheme, they warrant at least the opportunity to continue discovery, for the limited evidence presented by the defendants might have been rebutted if Alabama Farm had been allowed complete discovery, or even if it simply had been allowed access to the complete minutes of AMFI's Board of Directors' meetings. Alabama Farm may be unsuccessful in this action, but it is at least entitled to a fair opportunity to develop its case.[17]

We are well aware of the fact that the mere threat of discovery may cause substantial expenses to be incurred by litigants. In class actions in particular discovery can be used to coerce defendants. Flimsy cases are sometimes undertaken for just such a purpose. However, because the opportunity to have a full trial turns on the presence of still-disputed issues of material fact, a suit that asserts a tenable legal claim must not be aborted. Although Alabama Farm's suit is premised, at this point, on unproved inferences from circumstantial evidence, it states a cause of action and involves disputed issues of fact; therefore, under

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[17] It may be, as the dissent argues, that Alabama Farm is engaged in harassment as the result of its efforts to gain control of AMFI. The facts with respect to this are, like many others in this case, not known. Alabama Farm brings this action not on its own behalf but on behalf of AMFI, as a derivative stockholder's action. The deception it alleges was, it contends, worked on the corporation. We do not here decide that the suit has merit; we simply hold that its dismissal came before the plaintiffs had adequate opportunity for discovery and, therefore, before it could be known whether there were any genuine disputes as to material facts.

the Federal Rules of Civil Procedure, Alabama Farm has a right at least to further discovery. *See Subin v. Goldsmith, supra,* 224 F.2d at 761.

III. *The Alleged Violations of § 14(a) and Rule 14a-9*

Alabama Farm alleged numerous misstatements and omissions in the proxy materials and supplemental proxy materials issued by AMFI. On consideration of these materials, the district court found that Alabama Farm's allegations were ill-founded. We agree.

None of the alleged misrepresentations and omissions in the proxy materials concerned the adequacy of the disclosure made regarding the scope of the repurchase program or how it would be carried out. In its amended complaint, Alabama Farm did not assert that the proxy statement should have disclosed the alleged intent of the directors to inflate the price of AMFI stock, or that this would necessarily be the result of their actions. If such issues had been raised in the pleadings, summary judgment would have been improper. However, summary judgment was appropriate with respect to the allegations that Alabama Farm did make.

For the reasons set forth above, the grant of summary judgment for the defendants on Count I of the amended complaint is REVERSED, and the grant of summary judgment on Count II is AFFIRMED.

SKELTON, Senior Judge, concurring in part and dissenting in part:

I agree with the holding of the majority that American Fidelity (AMFI) did not violate § 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a) (1970), and Rule 14a-9 of the SEC, 17 C.F.R. § 240.14a-9 (1976) in the mailing of proxy and supplemental proxy statements, because, as held by the district judge, there were no significant misstatements or omissions in the proxy materials.

I also agree with the decision of the majority that AMFI succeeded in establishing the absence of any genuine issue of material fact as to the subjective motivation of its directors and officials in adopting the repurchase program and as to the effect of the program on the company's capital and surplus. The majority correctly approved the action of the district court in finding that the undisputed facts show that the company had adequately disclosed the existence, size and effect of the program, and that Rule 10b-5 does not require corporate directors and officers to disclose their subjective motivation in adopting a stock repurchase program.

I also agree that Counts III and IV involving state claims were properly dismissed.

However, I cannot agree with the majority's decision to reverse the case for a hearing on Alabama Farm's allegations that the repurchase plan was a device to manipulate the market in AMFI's shares and thereby inflate the market price of the shares in order to preserve the defendant's control over the AMFI, and that as a part of this scheme the defendants failed to disclose the inflationary effect AMFI's repurchases would have on the market price of its outstanding shares, all in violation of § 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5. In my opinion, there is no genuine issue as to any material fact regarding these allegations of Alabama Farm and, therefore, a new trial is not warranted.

The majority correctly states:

> "The Supreme Court has cautioned that '"[m]anipulation"' is '" virtually a term of art when used in connection with securities markets."' *Sante Fe Industries, supra*, 430 U.S. at 476, 97 S.Ct. at 1302, 51 L.Ed. 2d at 493, quoting *Ernst & Ernst v. Hochfelder*, 1976, 425 U.S. 185, 199, 96 S.Ct. 1375, 1384, 47 L.Ed.2d 668, 680. 'The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are

> intended to mislead investors by *artificially* affecting market activity.' (Emphasis supplied). *Santa Fe Industries, supra,* 430 U.S. at 476, 97 S.Ct. at 1302, 51 L.Ed.2d at 493-494. 'Manipulation' has referred, in general, to devices used to induce investment in a company's stock, not to devices implemented to discourage such investment."

Notwithstanding the above decisions of the Supreme Court, the majority takes the opposite view and holds that "manipulation" by a corporation refers to devices used by it to *discourage* investment by others in its stock, and that such conduct by AMFI in the instant case acted as a deceit or worked as a fraud on AMFI or on those who have invested in its stock. I do not agree.

There was no deceit nor fraud practiced by AMFI in connection with its repurchase plan. There is no allegation by Alabama Farm of any fact that shows any purpose, plan or intent on the part of AMFI to inflate the market price of its stock by its repurchase plan. Furthermore, the execution of the plan by AMFI did not inflate the market price of its stock. The facts show that the stock was originally issued for $25 a share. Later, and prior to the time of the repurchase plan, it reached $45 a share. Thereafter, it fell to $10 a share. AMFI repurchased its stock for an average of $8.41 a share. Where is the inflated price?

Also, it should be pointed out that Alabama Farm purchased 300,000 shares of AMFI stock (approximately 20% of the then outstanding shares) for the total sum of $2,530,000.00. No one forced it to buy this stock. We can assume that it made these purchases voluntarily and at prices that were satisfactory to it. Where was the deceit or the fraud? In my opinion, they were totally lacking. There was no violation of § 10(b) or Rule 10b-5 by AMFI.

The majority holds that there is a question of fact as to whether AMFI practiced deception in its initial press re-

lease that its purchases would be carried out in a manner that would not unduly affect the market. As a matter of fact, this is exactly what AMFI did. It purchased the stock in small lots over a long period of time. No one was deceived or misled. The price of the stock was not inflated by reason of its purchases.

I agree with the decision of Judge Tjoflat when he, acting as a district judge, granted summary judgment for the defendants on this phase of the case on the ground that Rule 10b-5 was not violated because there was no "deception" of or "injury" to the plaintiffs in connection with the repurchase program. I would add that there is no genuine issue of any material fact on this part of the case.

I would affirm the judgment of the district court on both Count I and Count II.[1]

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[1] In my opinion, this case is much ado about nothing and borders on being frivolous. It is obvious that Alabama Farm evolved a plan to take control of AMFI one way or another. At first it sought to do this by buying 300,000 shares of AMFI's stock. When this plan failed to produce the desired results, it embarked on a course of conduct involving legal harassment, coercion and intimidation to gain control of AMFI. All of this is shown by Alabama Farm's pleading and conduct whereby it filed two suits in Federal courts in two different states and a third in a state court and in connection with such suits, which were consolidated into the present case, it attempted to take 38 depositions and filed 15 motions in connection therewith. These motions were obviously without merit, as the district court never acted on them. As a part of its case, Alabama Farm is making demand on AMFI for $3,423,078 in damages without alleging any fact that would entitle it to even $1 in damages. However, the making of the claim in such a large amount is itself an harassment and an intimidation. It appears to me that AMFI has done no wrong and that Alabama Farm is the bad actor in this scenario. A reversal of this case would enable Alabama Farm to subject AMFI to more harassment and intimidation. I do not think we should allow our courts to be used for such purposes.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF FLORIDA
PENSACOLA DIVISION

PCA No. 75-60

ALABAMA FARM BUREAU MUTUAL CASUALTY INSURANCE COMPANY, INC., a corporation organized under the laws of the State of Alabama, on its own behalf, and on behalf of all other shareholders of American Fidelity Life Insurance Company in the right of and for the benefit of American Fidelity Life Insurance Company,
Plaintiff,

vs.

AMERICAN FIDELITY LIFE INSURANCE COMPANY, a corporation organized under the laws of the State of Florida; CHARLES P. WOODBURY, JOSEPH F. MARQUES, JR., R. E. MAUCH, TERRY M. RICHARDSON and RICHARD E. MERTINS, individually and as directors or officers of American Fidelity Life Insurance Company; and ROBERT F. SIKES, EUGENE C. SMITH, FRANK W. HULSE, and R. EMMETT RIERA, as Directors of American Fidelity Life Insurance Company,
Defendants.

MEMORANDUM AND ORDER

In December 1974 plaintiff Alabama Farm Bureau Mutual Casualty Insurance Company, Inc., ("Alabama Farm") filed this derivative action in the United States District Court for the Middle District of Florida charging American Fidelity Life Insurance Company ("AMFI") and five of its directors with various violations of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.* (1970 & Supp. V 1975). Alabama Farm subsequently filed two other actions in separate jurisdictions against AMFI and

its directors raising claims closely related to the action initially filed in this court. After a hearing in April 1975, this court denied plaintiff's request for preliminary relief and entered an order enjoining further prosecution of the other suits and requiring Alabama Farm to file an amended complaint presenting all related claims.[1]

In May 1975 plaintiff filed the amended complaint which is now before the court. Count I charged that the individual defendants violated section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970), and rule 10b-5 of the Securities and Exchange Commission ("SEC"), 17 C.F.R. § 240.10b-5 (1976), by causing AMFI to launch a stock repurchase program resulting in the acquisition of over 300,000 shares of AMFI common stock during 1974. Plaintiff sought $3,423,078 in damages.[2] Count II charged that defendants violated section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a) (1970), and rule 14a-9 of the SEC, 17 C.F.R. § 240.14a-9 (1976), by mailing proxy and supplemental proxy statements containing material misstatements and omissions. The plaintiff sought a declaratory judgment declaring all proxies obtained by use of the disputed proxy statements null and void and declaring the stockholders meeting of April 22, 1975, at

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[1] The first of the two collateral actions was filed on April 9, 1975, in the United States District Court for the Middle District of Alabama seeking to enjoin AMFI's upcoming annual stockholders meeting of April 22, 1975. The second was filed in the Circuit Court for Escambia County in Pensacola, Florida, on April 10, 1975, charging certain violations of Florida law governing the right of stockholders to inspect corporate records. The allegations of the complaint in the Alabama action are now contained in Count II of the amended complaint in the present case, while the allegations of the complaint in the state court suit are now contained in Counts III and IV of the amended complaint in the present case.

[2] Plaintiff's initial complaint had sought approximately $1,800,000 in damages; hence, this was the figure used in the proxy materials discussed *infra*.

which these proxies were voted, unlawful and all acts and resolutions of that meeting null and void; plaintiff also requested an order directing that a new stockholders meeting be held and providing for the solicitation of new proxies. Counts III and IV asserted pendent state claims.

Defendants filed a motion to dismiss the amended complaint or in the alternative for summary judgment, and they also filed a motion to stay discovery. Plaintiff filed a motion for partial summary judgment and a motion to compel answers to interrogatories and for production of documents. The court granted defendants' motion to stay discovery and held a hearing on the motion to dismiss and the motions for summary judgment. For reasons stated herein, the court now grants defendants' motion for summary judgment on Counts I and II and grants without prejudice the motion to dismiss Counts III and IV for want of jurisdiction. Plaintiff's motion for partial summary judgment is denied.

THE FACTS

The complaint and the affidavits and exhibits in the record reveal the undisputed facts to be as follows.[3] AMFI is a corporation organized and existing under the general corporation and insurance laws of the State of Florida. As of December 31, 1973, before the stock reacquisition program, AMFI had issued outstanding capital stock consisting of 1,812,735 shares. [Complaint, Count I para. 9.] These shares had originally been issued in the early 1960s

[3] The record contains *inter alia* (a) defendants' chart setting forth a comparison of plaintiff's alleged material misstatements and omissions and statements from the March 24, and April 14, 1975, proxy materials, (b) the affidavit of L. Bradshaw Southerland and exhibits thereto, (c) the affidavits of Richard E. Mertins sworn to May 16, 1975 ["Mertins"], and June 25, 1975 ["Mertins Proxy"], and exhibits thereto, which contain all the relevant proxy materials, and (d) the affidavits of B. P. Richardson and Henry K. Knowlton.

at an average price of $25.00 per share. [Mertins para. 10.] On January 2, 1973, the price of AMFI stock on the over-the-counter market reached a high of $45.00 per share; however, thereafter the price fell as part of a general market decline until it was selling in the range of $8.00 to $9.00 per share. [*Id.*] When the price fell the plaintiff started to invest heavily in AMFI, spending over $2,500,000 of corporate funds between October 1973 and September 1974 to purchase AMFI common stock. In the 13D Schedules which plaintiff filed with the SEC and AMFI pursuant to section 13D of the Securities Exchange Act of 1934,[4] plaintiff described its AMFI purchases as a good investment: "The stockholder feels that the securities of the insurer are selling at much less than is normal for a life insurance company with the amount of business in force as has American Fidelity." [Mertins para. 9, Exhibits K through Q.]

AMFI's Board of Directors first formally considered repurchasing some of the company's own stock at its Executive and Finance Committee meeting on September 18, 1973. [Mertins para. 4, Exhibit A.] At that time the full Board of Directors consisted of thirteen directorships; however, only twelve of these were filled. [Mertins para. 4, Exhibit B.] Ten of the twelve active directors attended the September 18 committee meeting, and they unanimously approved a motion that Florida law be checked to see if AMFI could repurchase its own stock for retirement. [*Id.*] At the next committee meeting, held on October 16, 1973, seven out of eight committee members attended and unanimously approved a resolution that AMFI seek permission from the State of Florida and the SEC to repurchase up to $2,000,000 of its own stock on the open market. [Mertins para. 4, Exhibit D.] On October 31, 1973, the full Board of Directors met with nine out of twelve active members attending. After hearing the report of the Executive and Finance Committee meetings of September 18 and October 16,

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[4] 15 U.S.C. § 78m(d) (1970).

the Board unanimously approved the Committee's actions, including the stock repurchase decision. [Mertins para. 4, Exhibit E.] AMFI's by-laws were subsequently amended to reduce the number of AMFI directorships to nine. [Mertins para. 5.]

The stock reacquisition program was launched on January 2, 1974, with a press release announcing AMFI's intention to purchase $2,000,000 of its common stock on the open market and in a manner that would not unduly affect the market for the stock. [Mertins para. 12, Exhibit T.] This disclosure was followed on February 28, 1974, by a press release announcing AMFI's 1973 income and describing the drop in earnings from the previous year as the result of tax liability due to the company's stock repurchase program. [Mertins para. 12, Exhibit U.] The repurchase program, its impact on surplus and its tax consequences were also described in AMFI's 1973 Annual Report, which was mailed to stockholders on March 26, 1974. [Mertins para. 11, Exhibit R.] At the annual stockholders' meeting the following month, it was disclosed that AMFI had succeeded in acquiring pursuant to its stock repurchase program 165,626 shares of its own stock at a cost of $1,404,646.82. [Mertins para. 12, Exhibit W.] One Mr. Donald Pierce, representing the plaintiff, attended the meeting and voted plaintiff's shares in support of a resolution which was passed ratifying and confirming all acts of the Board of Directors and officers during the preceding year. [*Id.*] On April 24, 1974, the day after the annual meeting, AMFI issued another press release discussing the stock repurchase program. [Mertins para. 11, Exhibit X.] These disclosures were followed by the Mid-Year Report mailed to stockholders on August 1, 1974. [Mertins para. 11, Exhibit Z.] The financial data set forth in the report reflected the increase in treasury shares held due to the repurchase program. Finally, on September 24, 1974, AMFI issued a press release announcing that, although the company had not completed the initial $2,000,000 stock repurchase program, the amount authorized for expenditure in the pro-

gram had been increased to $3,000,000. [Mertins para. 11, Exhibit S.] The repurchase program continued, and by February 21, 1975, AMFI had acquired a total of 314,535 shares at an average price of $8.41 per share.

On March 24, 1975, the directors of AMFI mailed proxy materials to the company's stockholders in anticipation of the annual meeting to be held on April 22, 1975. These materials and plaintiff's initial complaint in the present action had previously been furnished to the SEC for its review pursuant to SEC regulation 14a-6, 17 C.F.R. § 240.14a-6 (1976). The proxy materials consisted of a notice of the annual meeting, a proxy statement, and AMFI's 1974 Annual Report, and they disclosed the existence and nature of plaintiff's present lawsuit. On April 9, 1975, the plaintiff responded by filing a second lawsuit in the United States District Court for the Middle District of Alabama seeking to enjoin the annual meeting.[5] Thereafter, on April 12, 1975, AMFI prepared and mailed to its stockholders a supplemental proxy statement which informed them of the allegations contained in the recently filed lawsuit. [Mertins Proxy para. 6.] Before these supplemental materials were distributed, they were submitted ot the SEC for its review. [*Id.*]

COUNT I

The first count alleges that the five individual defendants controlled AMFI and planned to perpetuate their control by foisting on AMFI the stock repurchase program. This conduct was allegedly fraudulent because the defendants did not disclose to either the full board or the stockholders their real motive (*e.g.*, perpetuating their control) and because in the various press releases accompanying the stock repurchase program they did not disclose various material facts: *e.g.*, the "inflationary impact" the program would have on the market price of AMFI stock, the adverse impact the program would have on AMFI, and the defen-

[5] See note 1, *supra*.

dants' "real motive." The complaint further alleged that the scheme damaged AMFI by depleting its statutory capital, reducing its policy writing capacity, and causing certain adverse tax consequences.

In light of the undisputed facts, these allegations are clearly insufficient. As was noted in *Bailes v. Colonial Press, Inc.*, 444 F.2d 1241, 1246 (5th Cir. 1971), "[t]he gravemen of a 10b-5 cause of action is deception." *See also Herpich v. Wallace,* 430 F.2d 792, 808-809 (5th Cir. 1970). Here the allegations on the element of deception are shallow and conclusory.[6] The record, on the other hand, reveals that AMFI fully disclosed its stock repurchase program to the stockholders and the public. No buyer or seller was deceived as to either the existence or size of the program. Stripped to their essentials, plaintiff's allegations concerning deception amount to no more than a claim that the management did not announce that its purpose in launching the stock repurchase program was to perpetuate its control of AMFI. Assuming arguendo that this was the defendants' motive, plaintiff cites no authority (and the court can find none) for the proposition that corporate managers must disclose not only the facts underlying a stock repurchase program but must also reveal their subjective motivations.

Furthermore, this circuit has previously held that "there are three basic elements to be pled and proved in 10b-5 actions: (1) conduct by the defendants proscribed by the rule; (2) a purchase or sale of securities by the plaintiffs 'in connection with' such proscribed conduct; and (3) *resultant damages to the plaintiffs.*" *Sargent v. Genesco, Inc.*, 492 F.2d 750, 759 (5th Cir. 1974) (emphasis added); *see also Woodward v. Metro Bank of Dallas,* 522 F.2d 84, 93 (5th Cir. 1975). Here, even if there was deception, it is

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[6] The few concrete allegations in Count I on the deception issue are identical to the allegations in Count II concerning the proxy materials. For reasons discussed *infra,* these allegations are insubstantial.

clear that there is no showing of any damage or injury. It is conceded that AMFI purchased all its shares on the open market at the prevailing free market price after fully disclosing its intention to do so. Under these circumstances no buyer or seller of AMFI stock was injured. The plaintiff argues that it was AMFI that was injured. The theory is that the stock was purchased at a price above the statutory book value of each share and that such purchases depleted AMFI's working capital and amounted to corporate waste. No facts or authorities are presented in support of this novel theory, however, for current market price is commonly considered a fair measure of value. *See, e.g., Kaufman v. Lawrence,* 386 F. Supp. 12 (S.D. N.Y. 1974), *aff'd,* 514 F.2d 283 (2d Cir. 1975). Moreover, by its actions the plaintiff as much as concedes that there was no injury. During the same time AMFI was allegedly wasting its corporate assets by purchasing its own stock, the plaintiff was also buying AMFI stock on the open market, and in the 13D schedules plaintiff filed with the SEC, plaintiff described AMFI's common stock as a good buy. Under these circumstances the plaintiff has failed to make any showing of injury and the claim must therefore fall. *See, e.g., Wolf v. Frantz,* 477 F.2d 467, 478 (5th Cir.), *cert. denied,* 414 U.S. 975 (1973).

COUNT II

Plaintiff's second count is directed at alleged material misstatements and omissions in AMFI's proxy materials. These alleged misstatements and omissions are set forth in seven subparagraphs (a through g) in paragraph twelve of Count II of the Complaint. A comparison of the allegations in each subparagraph with the proxy materials quickly reveals that the allegations are ill-founded.

(a) Plaintiff alleges that the proxy statement falsely stated that AMFI "would not benefit from the proceeds of any judgment which might otherwise be recovered from the

individual defendants." In fact the proxy statement stated *inter alia* that "*if the Company and the individual defendants are successful in defending against the claims asserted by Alabama Farm*, the Company would not benefit from the proceeds of any judgment which might otherwise be recovered from the individual defendants." (Emphasis added.) [Mertins Proxy, Exhibit A.] Thus the alleged misrepresentation in the proxy statement is "false" only when taken completely out of context.

(b) Plaintiff alleges that the proxy statement stated that a favorable vote at the stockholders meeting for which the proxy was solicited may assist "the individual defendants and the Company in their defense of such lawsuit." This statement is said to create the false impression that AMFI needed help in defending against the lawsuit when in fact AMFI would benefit from a money judgment against the individual defendants. However, in the preceding paragraphs of the proxy statement it was carefully explained that AMFI was only a nominal defendant in the pending lawsuit, that the suit was for the benefit of the company, and that the plaintiff sought a $1,800,000 judgment from the individual defendants to be paid to AMFI. Thus, once again, the allegedly false statement was taken out of context.

(c) Plaintiff alleged that the proxy statement failed to disclose that the pending lawsuit was a derivative action brought for the benefit of AMFI against the individual defendants for wrongdoing in their management of company. Here again, the plaintiff's allegation is not supported by the record. The proxy statement described the lawsuit in exactly the same language used by the plaintiff in its complaint: "The Company's stock purchases . . . are currently the subject of a lawsuit brought by [Alabama Farm] 'in its own behalf and in behalf of all other shareholders of American Fidelity similarly situated, in the right of and for the benefit of American Fidelity. . .'" Moreover, the

proxy statement specifically stated that the lawsuit sought $1,800,000 in damages for AMFI from the five individual defendants.

(d) Plaintiff alleged that the proxy statement did not disclose that the failure of the stockholders to approve the stock repurchase program would have three effects: (1) the possibility that AMFI would benefit from the failure to approve the program, (2) the possibility that AMFI management might be prohibited from making further purchases, and (3) the impact that the failure to approve would have on the pending lawsuit. An examination of the proxy materials refutes these contentions. The statement indicated that the individual defendants would be assisted in their defense of the lawsuit if proxies were granted to approve the stock repurchase program. Surely the converse was obvious: a vote by the stockholders not to approve the stock repurchase program would not assist the individual defendants in their defense of the lawsuit—a suit seeking to win $1,800,000 in damages from the individual defendants and to enjoin the continuation of the stock repurchase program.

(e) Plaintiff alleged that the proxy statement failed to disclose that various resolutions to be considered at the annual meeting for which the proxies were solicited would have the effect of perpetuating the present management's control of AMFI. Without reviewing here the lengthy disclosures in the proxy statements, it is sufficient to note that the contents of all resolutions were fully disclosed as well as many of the plaintiff's allegations concerning the intentions of AMFI's present management. What the proxy statement did *not* do was state that what the plaintiff alleged to be the motives and intentions of the defendants was *in fact true*. This of course was not required.

(f) Plaintiff alleged that the proxy material did not disclose the facts concerning certain mortgage loans owned by AMFI. While it is true that the mortgage details were

not set forth in the proxy statement, it is also true that a proxy statement cannot possibly disclose *everything* concerning a company's myriad financial affairs. However, the matter was mentioned in the proxy statement, and the statement contained an offer to send to any stockholder on request a free copy of a report filed with the SEC on the situation.

(g) Plaintiff alleged that the proxy statement failed to disclose various adverse affects that the stock repurchase program would allegedly have on the company. Whether or not these "adverse affects" would occur is, however, a matter of business judgment, and, while the proxy statement does present the underlying facts of the program, it does not (and need not) present *as fact* the plaintiff's conclusions concerning the wisdom of the stock repurchase program.

Finally, it should be noted that paragraph fourteen of Count II add two allegations concerning disclosures in the supplemental proxy. First, it is claimed that the additional material should have been disclosed in the first proxy statement; second, it is charged that the additional information was designed to confuse the shareholders. Both allegations are without merit. In fact, the supplemental proxy set forth in greater detail all the information allegedly omitted from the first proxy statement, and it also exhaustively set forth the allegations contained in the lawsuit plaintiff filed after the mailing of the original proxy materials.[7] This second proxy statement cured whatever legitimate grievance plaintiff had with the original statement.

COUNTS III & IV

The last two counts present purely state claims. As the court has previously determined that the first two counts are totally without merit, the pendent state claims of Counts

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[7] See text accompanying note 5, *supra*.

III and IV are dismissed without prejudice for want of jurisdiction. *See United Mine Workers v. Gibbs,* 383 U.S. 715 (1966).

It is therefore ORDERED:

(1) that defendants' motion for summary judgment on Counts I and II of the amended complaint is GRANTED, and those Counts are hereby DISMISSED with prejudice;

(2) that defendants' motion to dismiss Counts III and IV of the amended complaint without prejudice is GRANTED, and those Counts are hereby DISMISSED without prejudice; and

(3) that each party submit to the court within thirty (30) days a proposed final judgment.

DONE and ORDERED at Jacksonville, Florida, this 10th day of February, 1977.

/s/ GERALD BARD TJOFLAT
UNITED STATES CIRCUIT JUDGE
(Sitting by Designation)

cc: Counsel of Record

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 77-1661

D. C. Docket No. CA-75-60

ALABAMA FARM BUREAU MUTUAL CASUALTY INSURANCE COMPANY, INC., Etc.,
Plaintiff-Appellant,

versus

AMERICAN FIDELITY LIFE INSURANCE COMPANY, Etc., ET AL.,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Florida

Before SKELTON*, Senior Judge, HILL and RUBIN, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Florida and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed in part and reversed in part;

IT IS FURTHER ORDERED that each party bear their own costs on appeal in this Court.

November 15, 1979

Skelton, Senior Judge, concurring in part and dissenting in part.

Issued as Mandate:

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*Skeleton, Senior Judge of the United States Court of Claims, sitting by designation.

APPENDIX D

Notice of Order Denying Petition for Rehearing and Rehearing En Banc

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT
OFFICE OF THE CLERK

Gilbert F. Ganucheau
Clerk

TEL 504-589-6514
600 CAMP STREET
NEW ORLEANS, LA. 70130

January 15, 1980

TO ALL PARTIES LISTED BELOW:

No. 77-1661

ALABAMA FARM BUREAU MUTUAL CASUALTY, ETC.

VS.

AMERICAN FIDELITY LIFE, ETC.

Dear Counsel:

This is to advise that an order has this day been entered denying the petition( ) for rehearing, and no member of the panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 16) the petition( ) for rehearing en banc has also been denied.

See Rule 41, Federal Rules of Appellate Procedure for issuance and stay of the mandate.

Very truly yours,

GILBERT F. GANUCHEAU, Clerk
/s/ By H. E. ADAMS, JR.
Deputy Clerk

cc: Ms. Christine Reiger Milton
Messrs. John H. Wilbur
Dudley Allen
Mr. D. L. Middlebrooks
Mr. Charles N. Brower
Mr. Bert H. Lane
Mr. William H. Clark
Mr. Donald T. McNaughton

APPENDIX E

Notice of Stay of Issuance of Mandate

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT
OFFICE OF THE CLERK

Gilbert F. Ganucheau
Clerk

TEL 504-589-6514
600 CAMP STREET
NEW ORLEANS, LA. 70130

January 21, 1980

Mr. Charles N. Brower
Attorney at Law
1747 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

No. 77-1661

ALABAMA FARM BUREAU MUTUAL CASUALTY INSURANCE COMPANY, INC., ETC.,

VS.

AMERICAN FIDELITY LIFE INSURANCE COMPANY, ETC., ET AL.,

MANDATE STAYED TO AND INCLUDING February 20, 1980

Dear Counsel:

The court has this day granted a stay of the issuance of the mandate to the date as shown above. If during the period of the stay there is filed with the clerk of this court a notice from the clerk of the Supreme Court that the party who has obtained the stay has filed a petition for the writ in that court, the stay shall continue until final disposition by the Supreme Court. Upon the filing of a copy of an

order of the Supreme Court denying the petition for writ of certiorari, the mandate shall issue immediately under Rule 41, FRAP.

Under revised Rule 21(1) of the Supreme Court, effective July 1, 1970, a record is no longer required in connection with an application for writ of certiorari, and therefore, will not be routinely prepared by this office (38LW 3502).

A copy of the opinion, judgment and denial of rehearing are still required by the Supreme Court to be incorporated as an appendix to your petition. Enclosed are copies of the said documents which have been entered in this cause.

Very truly yours,

GILBERT F. GANUCHEAU, Clerk
/s/ CAROL G. LESAGE
Deputy Clerk

/bh
enc.
cc: Mr. John H. Wilbur
Mr. D. L. Middlebrooks
Mr. William H. Clark
Mr. Donald T. McNaughton

APPENDIX F

Order Extending Stay of Issuance of Mandate

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 77-1661

ALABAMA FARM BUREAU MUTUAL CASUALTY INSURANCE COMPANY, INC., Etc.,
Plaintiff-Appellant,

versus

AMERICAN FIDELITY LIFE INSURANCE COMPANY, Etc., Et Al.,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Florida

Filed February 20, 1980

ORDER:

( ) The motion of ..... for stay of the issuance of the mandate pending petition for writ of certiorari is DENIED.

( ) The motion of ..... for stay of the issuance of the mandate pending petition for writ of certiorari is GRANTED to and including ..... , the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within the period above mentioned there shall be filed with the Clerk of this Court the certificate of the Clerk of the Supreme Court that the certiorari petition has been filed. The Clerk shall issued the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon the expiration of the stay granted

herein, unless the above mentioned certificate shall be filed with the Clerk of this Court within that time.

(XX) The motion of appellees for a further stay of the issuance of the mandate is GRANTED to and including March 7, 1980, under the same conditions as set forth in the preceding paragraph.

/s/ ALVIN B. RUBIN
UNITED STATES CIRCUIT JUDGE

Supreme Court, U.S.
FILED
APR 21 1980
MICHAEL RODAK, JR., CLERK

No. 79-1362

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

AMERICAN FIDELITY LIFE INSURANCE COMPANY, CHARLES P. WOODBURY, JOSEPH F. MARQUES, JR., R. E. MAUCH AND RICHARD MERTINS,

Petitioners,

VS.

ALABAMA FARM BUREAU MUTUAL CASUALTY INSURANCE COMPANY, INC.,

Respondent.

BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

Docket No. 79-1362

AMERICAN FIDELITY LIFE INSURANCE COMPANY, CHARLES P. WOODBURY, JOSEPH F. MARQUES, JR., R. E. MAUCH AND RICHARD MERTINS,

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Respondent.

BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Respondent, Alabama Farm Bureau Mutual Casualty Insurance Company, Inc. ("Alabama Farm"), files this Brief in Opposition to the Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit filed by American Fidelity Life Insurance Company ("AMFI") and certain of its individual directors and officers, Charles P. Woodbury, Joseph F. Marques, Jr., R. E. Mauch and Richard Mertins, and submits that a grant of certiorari is not required in this case as the Opinion of the Fifth Circuit Court of Appeals ("the Opinion") creates no conflict with any decision of this Court and creates no real and embarrassing conflict with any decision of any Court of Appeals.

Alabama Farm accepts the statement of Petitioners in their Brief as to the "Opinions Below," "Jurisdiction," and "Statute and Regulation Involved."

QUESTIONS PRESENTED

Alabama Farm does not agree with Petitioners' "Statement of Questions Presented" and submits that the questions presented for review by this Court are:

1. Whether the Opinion, which held that summary judgment should not have been entered because genuine issues of fact were present as to whether the stock repurchase plan ("the Plan"), as intended and carried out, was a manipulative device that injured AMFI by artificially boosting the price of the shares purchased by AMFI and as to whether AMFI's shareholders were deceived by the nondisclosure of the scheme, conflicts with this Court's decision in *Santa Fe Industries, Inc. v. Green,* 430 U.S. 462 (1977) or any decision of a Court of Appeals.

2. Whether, under the facts of this case, the Opinion's statement that deception was adequately alleged: i) because the Court found questions of fact present as to whether the Defendants had failed to disclose certain facts and had misrepresented other facts; ii) because state law remedies would have been available if adequate disclosures had been made; iii) because the facts in the record presented a prima facie case for relief [App. 19a-21a] establishes a real and embarrassing conflict with the decisions of *Kidwell ex rel. Penfold v. Meikle,* 597 F. 2d 1273 (9th Cir. 1979) and *Wright v. Heizer Corp.,* 560 F. 2d 236 (7th Cir. 1977), *cert. denied,* 434 U.S. 1066 (1978), or otherwise establishes a basis for review by this Court.

STATEMENT OF THE CASE

Alabama Farm does not accept Petitioners' "Statement of the Case." The facts which are pertinent to the issue of this Court's jurisdiction are set forth below.

In December, 1974, Alabama Farm, a substantial shareholder of AMFI, filed an action in the United States District Court for the Middle District of Florida (the "Florida District Court") charging Petitioners with violations of Section 10(b) and Rule 10b-5 of the Securities Act arising from the Plan. [Appendix 3a] [hereinafter "App."]

In April, 1975, Alabama Farm filed a second lawsuit in the United States District Court for the Middle District of Alabama seeking to enjoin AMFI's annual shareholders' meeting based upon misstatements and omissions in the proxy materials distributed in connection with the meeting. [App. 4a]

In April, 1975, Alabama Farm filed a third action in the Circuit Court for Escambia County in Pensacola, Florida, seeking to exercise its right as a stockholder to inspect AMFI's books and records. [App. 4a]

At a hearing in April, 1975, the Florida District Court refused to enjoin the stockholders' meeting and entered an order enjoining further prosecution of the Alabama and the state court action and required Alabama Farm to file an Amended Complaint presenting all claims in the Florida District Court. [App. 4a]

In May, 1975, Alabama Farm filed the Amended Complaint presently before the Court. This pleading combined the charges made in all of the previously-filed actions and added one additional state law claim. [App. 4a]

Count I, the only Count at issue before this Court, charged that the individual Defendants violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) (1970) and

Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. §240.10b-5 (1976) by causing AMFI to implement the Plan resulting in the acquisition of over 300,000 shares of AMFI common stock during 1974. [App. 4a] The Amended Complaint alleged the individual Defendants entered into the Plan to perpetuate and maintain their control of AMFI by:

> . . . manipulating the market in the Shares and artificially inflating the market price of the Shares by causing American Fidelity to repurchase Shares in order to discourage other shareholders or nonshareholders from purchasing Shares or attempting to gain control of American Fidelity through the purchase of Shares. [Joint Appendix in Court of Appeals 4, Record 4] [hereinafter "J.A." and "R."]

The Amended Complaint also alleged that these Defendants deceived the shareholders because the Defendants failed to disclose the inflationary effect AMFI's repurchases would have on the market price of its outstanding shares. [J.A. 6, R. 6]

Commencing in January, 1975, Alabama Farm made numerous discovery attempts but these efforts were largely resisted by the Defendants, and the Florida District Court did not order full discovery. For example, all Defendants were served with Interrogatories in January, 1975, but only one Interrogatory was answered, and that was only after the Florida District Court had ordered a response. [App. 5a]

In January, 1975, Alabama Farm also sought the production of the minute books of AMFI's Executive Committee, Finance Committee and Board of Directors. These books were never produced even though Alabama Farm offered to examine them at any location specified by the Defendants so as not to disrupt AMFI's operations. The Florida District Court never heard nor ruled on two motions Alabama Farm filed seeking to compel production of these records. [App. 5a]

Alabama Farm scheduled thirty-eight depositions but only fifteen were actually taken with five of the fifteen restricted to discovery on a Motion to Transfer. AMFI filed fourteen motions for protective orders with respect to the depositions and Alabama Farm filed fifteen motions to compel answers to questions that witnesses refused to answer at the depositions. The Florida District Court neither heard nor ruled upon any of these motions. [App. 6a]

On December 22, 1975, the Florida District Court held a hearing on AMFI's Motion to Dismiss or, in the alternative, for Summary Judgment. A request for a stay of discovery was included in the Motion for Summary Judgment which was granted on February 13, 1976, by a different Judge than the one who heard the Motion to Dismiss or for Summary Judgment. Because the Judge who was considering the Summary Judgment motion had indicated that a ruling would shortly be issued, the second Judge granted a stay of discovery until ten days after the ruling on AMFI's Motion to Dismiss or for Summary Judgment. The ruling on the Summary Judgment motion, however, was not issued until one year later or on February 11, 1977. In the interim, Alabama Farm attempted to have the stay dissolved but was unsuccessful. [App. 6a]

An Order was issued on February 11, 1977 which granted Summary Judgment for the Defendants on Counts I and II and dismissed those Counts with prejudice. [App. 6a] Alabama Farm took a timely appeal to the Fifth Circuit Court of Appeals which Court reversed the judgment with respect to Count I and affirmed the grant of summary judgment with respect to Count II.

DECISION OF THE DISTRICT COURT

Alabama Farm does not accept Petitioners' statement of the "Decision of the District Court" but does not feel the District Court opinion is relevant or germane to the issue of this

Court's jurisdiction; thus, it will not include its own statement.

DECISION OF THE COURT OF APPEALS

Alabama Farm contends that Petitioners' statement of the "Decision of the Court of Appeals" misinterprets the holding of the Opinion. Alabama Farm submits that the Opinion held:

> A. Genuine issues of material fact were present as to whether the Plan, as intended and carried out, was a manipulative device that injured AMFI by artificially boosting the price of the shares purchased by AMFI and that genuine issues of material fact were present as to whether the shareholders were deceived by the nondisclosure of this scheme; thus, summary judgment was inappropriate at that stage of the proceedings. [App. 2a]
>
> B. Under the facts of this case, deception was adequately alleged: i) because the Court found questions of fact present as to whether the Defendants had failed to disclose certain facts and had misrepresented other facts; ii) because state law remedies would have been available if adequate disclosures had been made; iii) because the facts in the record presented a prima facie case for relief. [App. 19a-21a]

REASONS WHY THE WRIT SHOULD NOT BE GRANTED

There is no conflict between the Opinion and this Court's opinion in *Santa Fe Industries, Inc.* v. *Green, supra.* In *Santa Fe*, the complaint failed to allege a material misrepresentation or a material failure to disclose; the shareholders were furnished with all relevant information and no manipulative device was present. In the instant case, the Opinion held there were genuine issues of fact present as to whether there was a material misrepresentation and a material failure to disclose; whether the shareholders were furnished with all

relevant information; and whether the Plan was a manipulative device that injured AMFI. [App. 2a]

The Opinion does not conflict with *Rodman v. Grant Foundation*, 608 F.2d 64 (2d Cir. 1979); *Biesenbach v. Guenther*, 588 F.2d 400 (3d Cir. 1978); and *Golub v. PPD Corp.*, 576 F.2d 759 (8th Cir. 1978); instead, it follows those decisions. Those cases held under the Securities Laws a director need not disclose his subjective motives in connection with a transaction; the Opinion held under the Securities Laws a director need not disclose his subjective motives in connection with a transaction. [App. 11a]

There is no real and embarrassing conflict between the Opinion and the cases of *Kidwell ex rel. Penfold v. Meikle*, *supra*, and *Wright v. Heizer Corp.*, *supra*. Those cases state that to establish the requisite deception under 10b-5, a plaintiff must show: a) a misrepresentation or omission; b) that he could have maintained a state court action; and c) that he would have prevailed on the merits. Those cases are readily distinguishable from the Opinion as in the instant case the Court did not have before it a complete record as Alabama Farm was deprived of all meaningful discovery. Thus, under the facts of this case, it would have been impossible for the Opinion to have determined if the plaintfiff would have prevailed. In *Kidwell*, the Court had before it a "lengthy record" and in *Wright*, the Circuit Court review was premised upon the record after a full trial in the District Court. Additionally, certiorari should not be granted in this case because there are alternative grounds for affirmance; hence, the issue of "deception" is academic. Further, because of the incomplete state of this record, the Court should not grant certiorari to review this case as further discovery and factual development may

resolve many issues in the case and alleviate the need for this Court's review.

This Petition for Writ of Certiorari presents no real and substantial questions for this Court's determination and demonstrates no true conflict as required for this Court to exercise its discretion and accept jurisdiction. The Petition for Writ of Certiorari should be denied.

ARGUMENT

I. THERE IS NO CONFLICT BETWEEN THE OPINION AND THIS COURT'S OPINION IN *SANTA FE INDUSTRIES, INC. v. GREEN* OR BETWEEN THE OPINION AND ANY DECISION OF A COURT OF APPEALS.

A. Issues of Fact were Present Concerning the Existence of Manipulation.

Santa Fe held that a claim of fraud and fiduciary breach states a cause of action under Rule 10b-5 only when the conduct alleged can be fairly viewed as manipulative or deceptive. Finding the allegations of manipulation insufficient in the *Santa Fe* complaint, this Court broadly defined manipulation to encompass those activities that ". . .are intended to mislead investors by artificially affecting market activity." 340 U.S. at 476.

Instead of conflicting with *Santa Fe*, the Opinion follows it by finding issues of fact as to the presence of a manipulative scheme through the implementation of the Plan which was intended to mislead investors and deter market activity in the stock by artificially inflating prices. [App. 2a, 14a] This scheme, the Opinion held, presented genuine issues of fact sufficient at that stage of the proceedings to preclude summary judgment. [App. 2a]

Contrary to Petitioners' assertions, it was the *manner* in which the Plan was effectuated and not the *reason why* it was effectuated which the Court found presented genuine issues of material fact concerning manipulation under Rule 10b-5. Petitioners allege conflict between the Opinion and *Santa Fe* on this issue by stating:

> . . .the Court made its fundamental error by concluding that an alleged undisclosed motive made the entire stock repurchase plan a "manipulative device" such that disclosure of the alleged motive was required.
>
> *Santa Fe* does not permit such a conclusion. Alleging that an otherwise proper corporate transaction was occasioned by improper motives cannot transform that otherwise proper transaction into a "manipulative" device within the meaning of Section 10(b). . . .[Petitioners' Brief, p.17]

Alabama Farm submits that Petitioners misinterpret the Opinion as the Opinion did *not* find sufficient allegations of manipulation based upon Petitioners' failure to disclose their "improper motives." Genuine factual issues relating to manipulation were found in Petitioners' *conduct* which was designed to deter investment and was intended to manipulate artificially the market in AMFI stock and to inflate artificially prices in the stock. The Opinion's holding on this issue is clear as it stated:

> However, read as a whole, the complaint, as quoted above, asserts *a scheme artificially to manipulate the market and artificially* (that is, beyond the operation of normal market factors) *to inflate prices.* (emphasis supplied) [App. 14a]

Petitioners attempt to create conflict with *Santa Fe* by claiming the Plan was a fully-disclosed standard stock transaction which, when effectuated on the open market and with full disclosure of its terms, was not a manipulative device. This contention has no merit because the Opinion expressly

found the Plan was not fully disclosed. [App. 17a] Furthermore, whether or not it was a "standard stock transaction effectuated on the open market" is not the issue. The issue is whether the "standard stock transaction" was effectuated on the open market in such a manner that the market in the stock was affected artificially and investors were misled. Because the Court found there were issues of fact as to whether a scheme was present to manipulate artificially the market and to inflate artificially AMFI's stock prices, it concluded, pursuant to *Santa Fe*, that summary judgment was improper. [App. 2a, 14a] Thus, Alabama Farm submits that no conflict exists between *Santa Fe* and the Opinion and the Petition for Writ of Certiorari should be denied.

B. Issues of Fact were Present Concerning the Existence of Deception.

In *Santa Fe*, the case was presented to the Court on the premise that, although the complaint did not contain allegations of a material misrepresentation or a material failure to disclose, such allegations were not necessary to state a 10b-5 claim. 340 U.S. at 470. This Court in *Santa Fe* forcefully rejected that contention and held, in the absence of allegations of manipulation, a cause of action may be stated under Rule 10b-5 only if the conduct alleged is deceptive. 340 U.S. at 473-474. In *Santa Fe*, because the shareholders were presented with all facts, the Court found no deception was present and no 10b-5 cause of action was stated.

Contrary to the factual situation in *Santa Fe*, the Opinion in the instant case found sufficient factual allegations of deception in:

> . . .defendants' failure to disclose that the repurchase plan was to be carried out in a manner that would artificially inflate the price of AMFI's stock in order to benefit the defendants personally and in their misrepresentation in the initial press release that the purchases would be carried out in a manner that would not unduly affect the market. [App. 17a]

Unlike the *Santa Fe* shareholders, therefore, the AMFI shareholders were *not* presented with all facts concerning the Plan. Thus, the Opinion found deception was adequately alleged.

Petitioners, in seeking to establish conflict with *Santa Fe*, claim the Opinion found there was full disclosure:

> Here, the Court of Appeals agreed with the findings of the District Court that the directors had fully disclosed all the material terms of the stock repurchase program and all of the facts relating thereto. [Petitioners' Brief, p.13]

Although the Opinion did find the size and scope of the Plan were adequately disclosed along with the fact that one effect of the Plan would be to decrease AMFI's capital and surplus, the Opinion did *not* find the directors had fully and adequately disclosed all the material terms and all of the facts relating to the Plan as shown by the portion of the Opinion quoted on page 10, *supra*.

Petitioners next attempt to create conflict with *Santa Fe* and with the opinions of *Rodman v. Grant Foundation*, *supra*, *Biesenbach v. Guenther*, *supra*, and *Golub v. PPD Corp.*, *supra*, by claiming:

> Thus, the only issue is whether an allegation that the directors had the maintenance of existing corporate control relationships as their motive in approving a fully disclosed stock repurchase program creates Section 10(b) liability under *Santa Fe*. [Petitioners' Brief, p.13]

This is not an accurate statement of the finding of the Opinion concerning deception as the Opinion specifically held disclosure of motives need *not* be made:

> Section 10(b) and Rule 10b-5 were promulgated to prevent fraudulent practices in securities trading and trading on inside information. *See, e.g., Santa Fe Industries,*

> *supra. They were not intended to require, under normal circumstances, the disclosure of an individual's motives or subjective beliefs, or his deductions reached from publicly-available information.* (emphasis supplied) [App. 11a]

Furthermore, the Opinion did not find the Plan was a "fully disclosed stock repurchase program" based upon its explicit holding quoted on page 10, *supra*, which found adequate allegations of a misrepresentation and an omission in conjunction with the Plan. The Opinion's holding that summary judgment was improper because sufficient factual allegations concerning deception were present creates no conflict with any decision; thus, the Petition for Writ of Certiorari should be denied.

C. Issues of Fact were Present Concerning Whether a Federal Claim under Section 10(b) and Rule 10b-5 was Stated.

The Opinion found, based upon disputed issues of material fact concerning the existence of manipulation, deception and injury to AMFI as a result of the Plan, that Summary Judgment was improper, that a Rule 10b-5 cause of action was stated and that Alabama Farm had a right to further discovery. [App. 2a, 25a-26a]

Despite these findings, Petitioners contend that no federal claim was stated and that conflict exists with *Santa Fe* because they allege the Opinion permits a Rule 10b-5 claim to be established by:

> . . .alleging corporate mismanagement coupled with the subjective personal motive to retain control. . . . [Petitioners' Brief, p.21]

Petitioners then summarize their view of what the Opinion required and the basis of the conflict with *Santa Fe*:

> Requiring disclosure of subjective information, motive and intent of individual directors, and anticipated and

> speculative effects from transactions will rarely illuminate the facts already disclosed, but will only serve to confuse and mislead. To make nondisclosure of subjective motivation actionable under Section 10(b) is inconsistent with the fundamental approach of the federal securities laws. [Petitioners' Brief, p.22]

Alabama Farm submits that this statement reflects that Petitioners have completely misconceived the holding of the Opinion for the following reasons:

1. The Opinion held Section 10(b) and Rule 10b-5 did *not* require the disclosure of subjective information and the motive and intent of individual directors:

> Section 10(b) and Rule 10b-5 . . . were not intended to require . . . the disclosure of an individual's motives or subjective beliefs. . . . [App. 11a]

2. The Opinion held Section 10(b) and Rule 10b-5 did *not* require the disclosure of anticipated and speculative effects of a transaction:

> When the nature and scope of a transaction are clear, it is not necessary for the corporate instigators to characterize the various effects of the transaction as favorable or unfavorable or to evaluate its overall effect; such characterization is a matter of judgment, not fact.
>
> * * *
>
> It was unnecessary for AMFI to outline any or all of the possible dangers that could be posed by a decrease in statutory capital and surplus; the disclosure that they would be decreased was adequate. [App. 12a-13a]

Petitioners overlook the fact that they were successful in persuading the Court that these disclosures were *not* necessary. Petitioners' misunderstanding of the Opinion does not create conflict with *Santa Fe* and the Petition for Writ of Certiorari should be denied.

II. THERE IS NO CONFLICT BETWEEN THE OPINION AND THE CASES OF *KIDWELL v. MEIKLE*. AND *WRIGHT v. HEIZER CORP.*

Petitioners erroneously conclude that the Opinion held that:

> . . .causation under Rule 10b-5 was established upon a showing that state law remedies would have been available if full disclosure of the motive and intent behind the stock repurchase plan had been made and that there was a prima facie case for relief. . . . [Petitioners' Brief, p.23]

Alabama Farm contends the Opinion did not so hold.

The Opinion, in discussing the adequacy of the allegations concerning deception, did not even discuss "motive and intent" in connection with this issue but considered: a) whether a misrepresentation or non-disclosure was present [App. 17a]; b) whether state law relief would have been available had adequate disclosures been made [App. 19a]; and c) whether the facts shown made out a prima facie case for relief. [App. 19a]

Applying that standard to the case before it, the Opinion concluded that each of these elements was present in spite of the incomplete state of the record but that it could not determine whether deception could be proved absent full discovery or eventual trial. [App. 21a] Because Alabama Farm was denied all meaningful discovery, it would have been virtually impossible at this stage of the proceedings for the Opinion to have reached any other conclusion or to have determined if Alabama Farm would or would not have prevailed in any state court action.

Petitioners urge that this holding creates conflict with the cases of *Kidwell v. Meikle, supra,* and *Wright v. Heizer, supra,* because those cases require a 10b-5 plaintiff to prove he could have prevailed in any state court action before he is entitled

to bring a 10b-5 claim. These cases do not present a real and embarrassing conflict with the Opinion and are readily distinguishable from the Opinion as the factual posture of the instant case is far different from that of either *Kidwell* or *Wright*. Throughout the Opinion, the Court stressed that Alabama Farm had been denied discovery on a whole-scale basis and that it was the:

> . . .vice of summary judgment at this stage that it was granted before all the disputed facts were known. [App. 22a]

The Opinion held that the allegations of the Amended Complaint stated a cause of action and involved disputed issues of fact and that Alabama Farm was entitled to a fair opportunity to develop its case. [App. 25a-26a]

The complete denial of discovery and the factual situation of the instant case were *not* present in *Kidwell* as that opinion commenced by stating the relevant facts were "gleaned from a lengthy record." 597 F.2d at 1278. There was no lengthy record underlying the Opinion in the instant case as Alabama Farm was stopped at every turn from completing any meaningful discovery.

The same reasoning is applicable to the opinion in *Wright v. Heizer*. *Wright* was appealed after a full trial on the merits, *Wright v. Heizer*, 411 F. Supp. 23, 26 (N.D. Ill. 1975); thus, all facts were before the Circuit Court of Appeals so it could determine the merits of the underlying state claim. The factual posture of that case was accordingly drastically different from that presented in the instant case. Because the record in the instant case is scanty, unlike those of *Kidwell* and *Wright*, the Court could *not* have determined whether or not Alabama Farm would have prevailed in a State court action; thus, no conflict is present with those cases.

Even if this Court should determine that a conflict exists among the Circuits on this issue, which Alabama Farm does

not feel has been created by the Opinion, certiorari should not be granted for two additional reasons:

1. There are alternate grounds for affirmance of the Opinion as it found issues of fact concerning manipulation were present in the instant case. For this reason, a 10b-5 action has been adequately alleged and Alabama Farm submits that the discussion concerning deception is academic or non-essential to the result reached by the Court of Appeals. Because a resolution of this issue would be irrelevant to the disposition of the lawsuit in the District Court, it is unnecessary for this court to exercise its discretionary jurisdiction to review this aspect of the case. *SS Monrosa v. Carbon Black Export, Inc.*, 359 U.S. 180, 183 (1959).

2. This Court, by reviewing the Opinion through certiorari at this time with the record in an inadequate and incomplete state because of the denial of discovery, risks an "inconclusive and divisive disposition of a case when time may further illumine or completely outmode the issues in dispute." *Rice v. Sioux City Memorial Park Cemetery, Inc.*, 349 U.S. 70, 77 (1955). Because there are alternate grounds for affirmance and because further factual development may resolve the uncertainties in the case and allow a court to determine if Alabama Farm could "prevail" in a state court action, no compelling reason is presented to justify review of the case at this time.

CONCLUSION

The Opinion correctly holds that genuine issues of material fact were present with respect to manipulation and deception in this case and that a Rule 10b-5 cause of action had been adequately alleged. No conflict exists between the Opinion and this Court's opinion in *Santa Fe Industries, Inc. v. Green* or any other case cited by Petitioners.

The Petition for Writ of Certiorari should be denied.

April, 1980

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INC.

APPENDIX A

APPENDIX A

ALABAMA FARM BUREAU MUTUAL CASUALTY COMPANY, INC., etc., Plaintiff-Appellant,

v.

AMERICAN FIDELITY LIFE INSURANCE COMPANY, etc., et al., Defendants-Appellees.

No. 77-1661.

United States Court of Appeals,
Fifth Circuit.

Nov. 15, 1979.

Rehearing and Rehearing En Banc
Denied Jan. 15, 1980.

• • • • • • • • • • •

Appeal from the United States District Court for the Northern District of Florida.

Before SKELTON*, Senior Judge, HILL and RUBIN, Circuit Judges.

ALVIN B. RUBIN, Circuit Judge:

The plaintiffs in this stockholders' derivative action seek to recover for alleged violations of Rules 10b-5, 17 C.F.R. § 240.10b-5 (1976), and 14a-9, 17 C.F.R. § 240.14a-9 (1976) of the Securities and Exchange Commission, and corresponding provisions of the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78n(a), in the course of a stock repurchase program instituted by the defendants in 1974 and 1975. Finding certain facts to be undisputed, the district court granted summary judgment for the defendants on the basis that: (1) Rule 10b-5 was not violated because there was no "deception" of or "injury" to the plaintiffs in connection with the repurchase program;

* SKELTON, Senior Judge of the United States Court of Claims, sitting by designation.

and (2) Rule 14a-9 was not violated because there were no significant misstatements or omissions in the proxy materials. The plaintiffs, who were never allowed to complete discovery in this matter, contest the court's conclusions and also assert that there was a genuine issue of material fact concerning whether the repurchase program was a "manipulative device" to boost the price of the corporation's stock and thereby protect management's control of the corporation. This is an issue that was raised in Alabama Farm's amended complaint but not directly considered by the district court. Despite the lengthy and able consideration of the issues by the trial judge on the motion for summary judgment, we find that there are genuine issues of material fact as to whether the stock repurchase program, as intended and carried out, was a manipulative device that injured the corporation by artificially boosting the price of the shares purchased by the corporation, and regarding whether the shareholders were "deceived" by the nondisclosure of this alleged scheme. It was, therefore, inappropriate, at least at the stage reached in the proceedings, to dispose of these portions of the case by summary judgment. With respect to the other charges, however, summary judgment was proper.

I. *Background*

American Fidelity [AMFI], a Florida life insurance company, issued stock to the public in the early 1960's at an average price of $25 per share. The stock, which is traded over the counter, reached a high of $45 per share on January 2, 1973; thereafter, during a general market decline the price fell until it was below $10 per share.

In September, 1973, a committee of AMFI's Board of Directors discussed repurchasing some of the company's stock. In October the committee voted to seek permission from the State of Florida and the SEC to repurchase up to $2,000,000 of its own stock on the open market.[1]

---

[1] AMFI then had outstanding 1,812,735 shares of capital stock.

Then, beginning in October, 1973, Alabama Farm began to buy AMFI stock. By November, 1974, it had spent $2,530,000, and had acquired over 300,000 shares, approximately 20 percent of the then outstanding stock.

Shortly after Alabama Farm commenced its purchases of AMFI stock, the AMFI Board unanimously approved its committee's decision to seek authorization for a repurchase program. The program was launched with a press release on January 2, 1974, which also stated the Board's intention to carry out the purchases in a manner that would not unduly affect the market for the stock. The repurchase program was also described in AMFI's 1973 annual report, its 1974 mid-year report, and in additional press releases issued during the course of the program. In September, 1974, AMFI issued a press release announcing that, although the company had not completed the initial $2,000,000 stock repurchase program, it had increased the amount authorized for the program to $3,000,000. By February, 1975, AMFI had acquired a total of 314,535 shares at an average price of $8.41 per share.

In December, 1974, Alabama Farm filed this action in United States District Court for the Middle District of Florida charging AMFI and five of its directors with various violations of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.*

On March 24, 1975, the directors of AMFI mailed proxy materials to the company's stockholders in anticipation of the annual meeting to be held on April 22, 1975, at which the shareholders were to vote on resolutions to approve the past stock repurchases and an amendment to AMFI's certificate of incorporation reducing the number of directors from twelve to nine. In addition, the proxy materials sought votes on resolutions to approve amendments to AMFI's by-laws raising to three-quarters of the outstanding common stock the percentage of common stock necessary to remove a director without cause or to con-

stitute a quorum for any meeting at which election or removal of directors was considered. The proxy materials consisted of a notice of the annual meeting, a proxy statement, and AMFI's 1974 Annual Report, and they disclosed the existence and nature of plaintiff's present suit.

Alabama Farm responded by filing a second lawsuit in the United States District Court for the Middle District of Alabama seeking to enjoin the annual meeting on the grounds that the proxy materials contained misstatements and omissions in violation of Rule 14a-9 of the SEC. Thereafter, AMFI mailed to its stockholders a supplemental proxy statement informing them of the allegations contained in the recently filed lawsuit.

Alabama Farm then filed another action, this time in the Circuit Court for Escambia County in Pensacola, Florida. This action charged violations of Florida law governing the right of stockholders to inspect corporate records. After a hearing in April, 1975, the Florida district court denied the plaintiff's request for preliminary relief and entered an order enjoining further prosecution of the other suits and requiring Alabama Farm to file an amended complaint presenting all related claims.

In May, 1975, Alabama Farm filed the amended complaint now before this court. This pleading combined the charges made in all of the previously filed actions and added one additional state law claim. Count I charged that the individual defendants violated § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970), and rule 10b-5 of the SEC, 17 C.F.R. § 240.10b-5 (1976), by causing AMFI to launch a stock repurchase program resulting in the acquisition of over 300,000 shares of AMFI common stock during 1974. The individual defendants were alleged to have entered into a plan "to perpetuate and maintain their control of American Fidelity by manipulating the market in the Shares and artificially inflating the market price of the Shares by causing American Fidelity to repurchase Shares in order to discourage other shareholders

or nonshareholders from purchasing Shares or attempting to gain control of American Fidelity through the purchase of Shares." The complaint also alleged that these defendants deceived the shareholders in numerous ways in executing this scheme, and sought $3,423,078 in damages.

Count II charged that the individual defendants violated § 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a) (1970), and Rule 14a-9 of the SEC, 17 C.F.R. § 240.14a-9 (1976), by mailing proxy and supplemental proxy statements containing material misstatements and omissions. The plaintiff sought a declaratory judgment declaring all proxies obtained by use of the disputed proxy statements null and void and declaring the stockholders meeting of April 22, 1975, at which these proxies were voted, unlawful and all acts and resolutions of that meeting null and void; plaintiff also requested an order directing that a new stockholders' meeting be held and providing for the solicitation of new proxies. Counts III and IV asserted pendent state claims.

Alabama Farm made a number of attempts to exercise its discovery rights, but they were largely resisted by the defendants, and the district court did not order full discovery. For example, the defendants were served with interrogatories in January, 1975, but only one interrogatory was answered, and that was only after the district court had ordered a response.

In January, 1975, Alabama Farm also sought the production of minute books of AMFI's Executive Committee, Finance Committee and Board of Directors. These books were never produced, even though Alabama Farm offered to examine them at any location specified by the defendants so as not to disrupt AMFI's operations. The district court never heard or ruled on two motions Alabama Farm filed seeking to compel production of these records.

Alabama Farm fared little better with its attempts to obtain depositions. Of thirty-eight depositions scheduled

by it, only fifteen were actually taken, with five of those restricted to a motion to transfer. The defendants filed fourteen motions for protective orders with respect to scheduled depositions. Alabama Farm found it necessary to file fifteen motions to compel answers to questions that witnesses refused to answer. The district court never heard or ruled on any of these motions.

On December 22, 1975, the district court held a hearing on the defendants' motion to dismiss, or in the alternative for summary judgment, and on the plaintiff's motion for partial summary judgment on one of the state law claims. A request for a stay of discovery was included in the motion for summary judgment, and was granted on February 13, 1976, by a different judge than the one who heard that motion. Because the judge who was considering the summary judgment motion had indicated that a ruling would shortly be issued, the second judge ordered Alabama Farm to stay discovery until ten days after the ruling on the defendants' motion to dismiss or for summary judgment. In fact, though, the ruling on the summary judgment motion was not released until a year later; on February 11, 1977, the court granted summary judgment for the defendants on Counts 1 and 2 and dismissed the state law claims without prejudice. In the interim, Alabama Farm was unsuccessful in its attempts to have the stay dissolved.[2]

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[2] We recognize that these matters arose at times when the district court was heavily burdened with demanding criminal trials and with the exigencies of the Speedy Trial Act; that the district had an inadequate number of judges to meet the demands of its trial calendar; and that the judge who had initially handled the case and later heard the motion for summary judgment had, in the meanwhile, been appointed to this court, and was, therefore, by that time attempting to carry an almost superhuman double load. Our observations in the opinion are, therefore, in no way critical of the intensive efforts that were obviously made by the trial judge to consider fully the issues in this complex case while under multiple pressures.

II. *The Alleged Violations of § 10(b) and Rule 10b-5*

Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), makes unlawful the use of "any manipulative or deceptive device or contrivance" in contravention of SEC rules. Rule 10b-5, promulgated by the SEC under § 10(b), prohibits, in addition to nondisclosure and misrepresentation, any "artifice to defraud" or any act "which operates or would operate as a fraud or deceit." A cause of action lies under Rule 10b-5 "only if the conduct alleged can be fairly viewed as 'manipulative or deceptive' within the meaning of the statute." *Santa Fe Industries, Inc. v. Green,* 1977, 430 U.S. 462, 473-74, 97 S.Ct. 1292, 1301, 51 L.Ed.2d 480, 492. A breach of fiduciary duty by majority stockholders or corporate officers without any manipulation, deception, misrepresentation or nondisclosure violates neither the statute nor Rule 10b-5; such a violation is actionable solely under state law. *Id.*

In this action Alabama Farm alleged that the individual defendants' conduct was fraudulent because they did not disclose to the Board or the shareholders either their real motive for adopting the repurchase program, which was allegedly to retain their position of control over AMFI,[3]

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[3] In a related allegation, Alabama Farm asserted that the defendants failed to disclose their possible "conflict of interest." The conflict of interest that allegedly should have been disclosed by them was their interest in maintaining control of the corporation.

Corporate directors and officers of a corporation are under a duty to disclose their interests in other parties that engage in transactions with the corporation. The existence of such interests in a party to a securities transaction with the corporation is "material" information to the corporation's shareholders or directors; thus, the failure to disclose such information is "deceptive" within the meaning of Rule 10b-5. *See Kidwell v. Meikle,* 9 Cir. 1979, 597 F.2d 1273, 1293; *Swanson v. American Consumer Indus., Inc.,* 7 Cir. 1969, 415 F.2d 1326, 1330. *Cf. TSC Indus., Inc. v. Northway,*

or the effect of the program on the company's statutory capital and surplus,[4] which under Florida law could adversely affect its ability to write new insurance.[5] The dis-

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Inc., 1976, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (§ 14(a) and Rule 14a-9 violation).

In this case, however, it is not alleged that the directors had a conflicting interest in another party to a corporate transaction. It is also not alleged that the ownership interests of the directors of AMFI were not disclosed; they were, of course, public information. Thus, any conflict of interest was readily apparent, *see Frigitemp Corp. v. Financial Dynamics Fund, Inc.*, 2 Cir. 1975, 524 F.2d 275, 282, or a matter of "characterization" of the purpose and effect of the transaction rather than of "fact." *See Goldberg v. Meridor*, 2 Cir. 1977, 567 F.2d 209, 218, n.8, *cert. denied*, 1978, 434 U.S. 1069, 98 S.Ct. 1249, 55 L.Ed.2d 771.

[4] Florida statutes specify those assets that the Florida Department of Insurance will consider in determining an insurer's financial status; these assets are called "admitted assets." Under this "statutory accounting," treasury stock (previously, issued stock owned by the corporation that issued it) is a "non-admitted asset", an asset that is not counted in determining the insurer's financial status. Fla.Stat. § 625-031(3). Thus, if an insurer purchases its own stock, or any other non-admitted asset with cash (an "admitted asset"), its statutory capital or surplus is reduced because an asset carried on its statutory accounting balance sheet is replaced by an asset that cannot be carried on this balance sheet.

[5] Florida law mandates that insurers maintain at least a specified minimum statutory capital and surplus. Fla.Stat. § 624.409. Should an insurer's statutory capital and surplus fall below these minimum amounts, the Department of Insurance can declare the insurer insolvent and place it in receivership. Fla.Stat. § 631.051. Problems may also arise even before this minimum level is reached.

If statutory capital and surplus is depleted to the point that the corporation is in danger of falling below the minimum levels established by statute, then the company will be rendered more vulnerable to investment losses. For example, under statutory accounting all the costs of writing a new policy must be accounted for in the year incurred, rather than amortized over the life of the policy. If an insurer has an unprofitable year, these expenses will deplete statutory capital and surplus, and if the insurer's

trict court found that the undisputed facts showed that the company had adequately disclosed the existence, size and effect of the program, and it held that Rule 10b-5 does not require corporate directors and officers to disclose their subjective motivation in adopting a stock repurchase program.

The burden is on the party seeking summary judgment to show that there is no genuine issue of material fact. The "party opposing the motion is to be given the benefit of all reasonable doubt in determining whether a genuine factual issue exists." *Kellerman v. Askew,* 5 Cir. 1976, 541 F.2d 1089, 1092. In considering a summary judgment motion, the inferences most favorable to the party opposing the motion will be drawn. *Boazman v. Economics Lab., Inc.,* 5 Cir. 1976, 537 F.2d 210, 214. Such inferences may create disputes regarding basic facts or regarding facts to be inferred from such facts.

"In applying the basic principles the factor of access to proof must, however, be seriously considered in ruling on a defendant's motion for summary judgment, particularly in [a stockholder's derivative action] where plaintiff's proof must come mainly from sources largely within the control of the defendants and from the mouths of the alleged wrongdoers." 6 *Moore's Federal Practice* ¶ 56.17 [60] at 56-1065 (1976 ed.) (footnotes omitted). Summary judgment should not, therefore, ordinarily be granted be-

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statutory capital is already at a low level, it may have to limit its writing of new insurance. Moreover, investment losses are charged directly to statutory capital and surplus; if substantial, they may force an insurer that has only the minimum level of capital and surplus to seek reinsurance of all or a substantial portion of one of its lines of insurance. This is disadvantageous to the insurer because its profits must be reduced to allow profit to the reinsurer, it must pay the reinsurer to administer the business, and it will incur additional administrative costs in reporting to the reinsurer.

fore discovery has been completed. *Goldberg v. Meridor,* 2 Cir. 1977, 567 F.2d 209, 213, *cert. denied,* 1978, 434 U.S. 1069, 98 S.Ct. 1249, 55 L.Ed.2d 771. *See also Schoenbaum v. Firstbrook,* 2 Cir. en banc 1968, 405 F.2d 215, 218 *cert. denied sub nom. Manley v. Schoenbaum,* 1969, 395 U.S. 906, 89 S.Ct. 1747, 23 L.Ed.2d 219. " 'Cases in which the underlying issue is one of motivation, intent, or some other subjective fact are particularly inappropriate for summary judgment, as are those in which the issues turn on the credibility of the affiants.' " *Slavin v. Curry,* 5 Cir. 1978, 574 F.2d 1256, 1267, quoting *Conrad v. Delta Air Lines, Inc.,* 7 Cir. 1974, 494 F.2d 914, 918.

Summary judgment may be improper, even though the basic facts are undisputed, if the ultimate facts in question are to be inferred from them, and the parties disagree regarding the permissible inferences that can be drawn from the basic facts. *Winter v. Highlands,* 5 Cir. 1978, 569 F.2d 297, 299. " '[T]he choice between permissible inferences is for the trier of facts.' " *Nunez v. Superior Oil Co.,* 5 Cir. 1978, 572 F.2d 1119, 1124, quoting, *Walker v. U.S. Gypsum Co.,* 5 Cir. 1959, 270 F.2d 857, 862, *cert. denied,* 1960, 363 U.S. 805, 80 S.Ct. 1240, 4 L.Ed.2d 1148. Where a jury is called for, the litigants are entitled to have the jury choose between conflicting inferences from basic facts. *Nunez, supra,* 572 F.2d at 1124. However, where the judge is the trier of fact, as was the case here, he may be in a position to draw inferences without resort to the expense of trial, unless there is an issue of witness credibility. *See id.* at 1124-25.

Applying these criteria, we find that the defendants did succeed in establishing the absence of any genuine issue of material fact related to the allegations we have just discussed. Although the plaintiff did not have an opportunity to complete discovery, some facts were so well established that it is not conceivable that they would ever be disputed, and no contention is made that countervailing evidence might be adduced regarding these points if further deposi-

tions or document examination were permitted. Thus, the fact that press releases were issued and their contents; the identity and contents of proxy statements; and certain other evidentiary facts established by documents are, indeed, undisputed. Considering this uncontroverted evidence, the district court correctly concluded that the plaintiff's allegations were either not sufficient to establish the requisite element of deception, even if proved, or were conclusively refuted.

Alabama Farm's thesis that the failure of a controlling stockholder or corporate official to disclose his motives in entering a transaction constitutes the "deception" requisite for a 10b-5 violation is not supported by the cases cited to us, e. g. *SEC v. Blatt,* 5 Cir. 1978, 583 F.2d 1325; *Goldberg, supra; Schoenbaum v. Firstbrook, supra; Subin v. Goldsmith,* 2 Cir. 1955, 224 F.2d 753, *cert. denied,* 350 U.S. 883, 76 S.Ct. 136, 100 L.Ed. 779; and *Fogelson v. American Woolen Co.,* 2 Cir. 1948, 170 F.2d 660. Nor has our own research disclosed any such circuit decisions. However, there is authority to the contrary. *Golub v. PPD Corp.,* 8 Cir. 1978, 576 F.2d 759, 765; *Joyce v. Joyce Beverages, Inc.,* 2 Cir. 1978, 571 F.2d 703, *cert. denied,* 1978, 437 U.S. 905, 98 S.Ct. 3092, 57 L.Ed.2d 1135. *See also O'Neill v. Maytag,* 2 Cir. 1964, 339 F.2d 764, 767; *see generally,* A. Fleischer, *Federal Corporation Law: An Assessment,* 78 Harv.L.Rev. 1146, 1166 (1965). *But see* A. Jacobs, 5A Securities Law Series, The Impact of Rule 10b-5, § 121.01 at 5-87 (1977). We believe that the position taken by these courts is sound. Section 10(b) and Rule 10b-5 were promulgated to prevent fraudulent practices in securities trading and trading on inside information. *See, e.g., Santa Fe Industries, supra.* They were not intended to require, under normal circumstances, the disclosure of an individual's motives or subjective beliefs, or his deductions reached from publicly available information.

In *Goldberg, supra,* cited by the appellants, numerous material facts, including the effect of an exchange of assets

for shares on the operating position of one of the corporate parties, were misrepresented. The defendants did not simply fail to disclose the purpose of the transaction; they falsely stated that the party whose shares were issued for an inadequate consideration was to become the principal operating corporate subsidiary in the resulting multi-corporate structure, when in actuality the transaction would seal its doom. Thus, the requisite "deception" was found on the basis of more than mere nondisclosure of the motive for the transaction. In addition, the court noted that it did "not mean to suggest that § 10(b) or Rule 10b-5 requires insiders to characterize conflict of interest transactions with pejorative nouns or adjectives." 567 F.2d at 218 n.8.

Of the other cases cited by the appellants, both *Subin, supra,* and *Fogelson, supra,* were diversity cases that involved alleged abuse of discretion by directors amounting to corporate waste. The motives of the directors in approving certain transactions were relevant to whether the directors had exercised "honest business judgment." Neither § 10(b) nor Rule 10b-5 was involved, and the cases clearly did not hold that directors must disclose their motives for approving corporate undertakings involving transactions in securities. In *Schoenbaum, supra,* and *Blatt, supra,* the issue was whether certain securities were purchased on the basis of undisclosed inside information concerning the value of the stock purchased. Neither case was concerned with the question of whether the defendants should have disclosed their "motive" in entering into the transaction. Although in *Schoenbaum* the court noted that "motive" may be important in many stockholders' derivative actions, it did not hold that disclosure of "motive," apart from material "facts", is required in securities transactions.

When the nature and scope of a transaction are clear, it is not necessary for the corporate instigators to characterize the various effects of the transaction as favorable or unfavorable or to evaluate its overall effect; such charac-

terization is a matter of judgment, not fact. *See Golub v. PPD, supra.* However, it is necessary for the impact of a transaction to be described factually to the extent that such information would be significant to a reasonable, disinterested director, *Goldberg, supra,* at 219, or shareholder, *Kidwell v. Meikle,* 9 Cir. 1979, 597 F.2d 1273, 1293 n.10; *Joyce, supra,* 571 F.2d at 706-07 & n.6. *See Wright v. Heizer Corp.,* 7 Cir. 1977, 560 F.2d 236, 247, *cert. denied,* 1978, 434 U.S. 1066 98 S.Ct. 1243, 55 L.Ed.2d 767 (if shareholder approval not required, disclosure to board of directors sufficient if majority is disinterested; otherwise, disclosure to shareholders is required). *Cf. TSC Industries, Inc. v. Northway, Inc.,* 1976, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed. 2d 757 (materiality standard for action arising under § 14(a) and Rule 14a-9).

In this case, as the district court found, the size and scope of the stock repurchase plan were adequately disclosed.[6] The initial press release also pointed out that one effect of the program would be to decrease the firm's "capital" and "surplus". It was unnecessary for AMFI to outline any or all of the possible dangers that could be posed by a decrease in statutory capital and surplus; the disclosure that they would be decreased was adequate.

In addition to the allegations discussed above, however, Alabama Farm alleged that the repurchase plan was a part of a "plan or scheme to perpetuate and maintain . . . control of American Fidelity by manipulating the market in [AMFI's] Shares and artificially inflating the market price of the Shares . . . in order to discourage other shareholders or nonshareholders from purchasing Shares or attempting

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[6] The defendants presented evidence of a number of disclosures made by AMFI, including press releases issued on January 2, 1974, February 28, 1974, April 24, 1974, and September 24, 1974, and statements in AMFI's 1973 annual report and in a mid-year report mailed to stockholders on August 1, 1974. Alabama Farm has never disputed the contents of these disclosures, or the fact that they were made.

to gain control of" AMFI. This plan was alleged to have damaged AMFI "for the sole personal benefit" of the defendants. Alabama Farm also asserted that, in connection with this scheme, the defendants omitted to disclose the inflationary effect AMFI's repurchases would have on the market price of its outstanding shares. In granting summary judgment the district court discussed neither this alleged manipulative device nor the significance of the alleged omission.

Of course, any person having rudimentary knowledge of securities trading would realize that a course of purchasing stock would tend either to increase the price of the stock or to avert a decline in price that might otherwise occur. The allegation would not, therefore, even state a claim for which relief might be granted if it contended only that the defendants failed to reveal the obvious or the well-known. However, read as a whole, the complaint, as quoted above, asserts a scheme artificially to manipulate the market and artificially (that is, beyond the operation of normal market factors) to inflate prices.

The defendants contend that the manipulation alleged is not within the scope of Rule 10b-5, because it is not the traditional type of manipulation at which Rule 10b-5 was directed. In addition, they assert that, for this type of manipulative scheme to fall within the prohibition of Rule 10b-5, nondisclosure is essential, and they argue that the undisputed facts show that there was adequate disclosure. Furthermore, they contend that the injury, if any, was to those who found it more difficult to purchase shares, not to the corporation, which purchased shares at what they claim to have been their fair market value, and that Alabama Farm, as a derivative plaintiff,[7] had no standing to assert

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[7] Without discussion of the kind of class or the kind of class action involved, and without notice to the class, the district court certified the case as a class action in the following terms:

1. This action is properly maintainable as a class action. The questions of law or fact common to the members of the class

injury to persons other than the corporation. These contentions are not enough to shore up the summary disposition of Alabama Farm's claims.

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predominate over questions affecting only individual members; in fact, the record does not suggest the existence of substantial questions affecting only individual members. The plaintiff is fully able to represent the class and to maintain this litigation. Furthermore, the maintenance of this action will render unnecessary, if not preclude, a multiplicity of suits by members of the class in other forums on claims arising out of the facts underlying the plaintiff's allegations in this case.

By the nature of the action this could be no more than the certification of a class of stockholders to whose ultimate benefit the derivative action might in part inure. The certification could not embrace the sellers of stock, and AMFI and American Fidelity were the only buyers. The district judge's comments during the hearing on the question of class certification are consistent with our conclusion that the class referred to in his order was a class of shareholders:

THE COURT: And I think I'll go ahead and find an appropriate class, but I think the notice to the class is something that the transferee judge ought to make.

MR. WILBUR: But you are maintaining a finding for the class?

THE COURT: You are in here representing an insurance company. You are fully liable to represent all the stockholders. Do you have any objection to the plaintiffs' insurance company as a proper representative of the class of stockholders?

* * * * * *

THE COURT: Well, I know that, but I think—they are entitled to a clear declaration of a class. I think——

MR. BROWER: I think there will be no problem about prompt and expeditious procedures in this case. That goes into the class action as well, Your Honor.

THE COURT: But you do not dispute the ability of the plaintiffs' insurance company to finance this lawsuit?

MR. BROWER: If it's a question——

THE COURT: And to represent the stockholders per se?

MR. BROWER: If it is a question of finance, I do not dispute the question of finance.

As the defendants note, the Supreme Court has cautioned that "'[m]anipulation' is 'virtually a term of art when used in connection with securities markets.'" *Santa Fe Industries, supra,* 430 U.S. at 476, 97 S.Ct. at 1302, 51 L.Ed.2d at 493, quoting *Ernst & Ernst v. Hochfelder,* 1976, 425 U.S. 185, 199, 96 S.Ct. 1375, 1384, 47 L.Ed.2d 668, 680. "The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by *artificially* affecting market activity." (Emphasis supplied.) *Santa Fe Industries, supra,* 430 U.S. at 476, 97 S.Ct. at 1302, 51 L.Ed2d at 493-494. "Manipulation" has referred, in general, to devices used to induce investment in a company's stock, not to devices implemented to discourage such investment.

Conduct designed to deter investment is within the scope of Rule 10b-5 when it acts as a deceit or works as a fraud on a corporation or those who have invested in its stock. *Cf.* A. Jacobs, 5A Securities Law Series: The Impact of Rule 10b-5 § 139.05[a] and [f] at 6-30, 6-37—6-39 (1977). Such conduct falls within the scope of the literal language of § 10(b) and Rule 10b-5 and is consistent with the congressional intent to proscribe intentional or willful conduct designed to deceive or defraud investors. As the Supreme Court has noted, § 10(b) is "described rightly as a 'catchall' clause to enable the Commission 'to deal with new manipulative [or cunning] devices.'"[8] *Ernst & Ernst, supra,* 425

THE COURT: Or to represent the stockholders?

MR. BROWER: There have been other reasons why they are not the proper representatives of the stockholders of this company.

THE COURT: Well, that is something you will have to bring up later.

[8] The Senate indicated in its report that § 10(b) was directed "at those manipulative and deceptive practices which have been demonstrated to fulfill no useful function." S.Rep. No. 792, 73d Cong., 2d Sess., 6 (1934). A corporation's purchase of its shares at artificially inflated prices would not appear to serve a useful purpose.

U.S. at 203, 96 S.Ct. at 1385, 47 L.Ed.2d at 682, quoting Hearings on H.R.7852 and H.R.8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 115 (1934) (remarks of Thomas G. Corcoran, a spokesman for the drafters of the provision that was to become § 10(b)). *See* A. Jacobs, 5A Securities Law Series: The Impact of Rule 10b-5 § 138.01 at 6-2—6-3. In addition, because this is "remedial" legislation, *SEC v. Capital Gains Research Bureau,* 1963, 375 U.S. 180, 195, 84 S.Ct. 275, 284, 11 L.Ed.2d 237, 248, it must be construed " 'not technically and restrictively, but flexibly to effectuate its remedial purposes.' " *Affiliated Ute Citizens v. United States,* 1972, 406 U.S. 128, 151, 92 S.Ct. 1456, 1471, 31 L.Ed.2d 741, 760, quoting *SEC v. Capital Gains Research Bureau, supra,* 375 U.S. at 186, 84 S.Ct. at 280, 11 L.Ed.2d at 243. *See also A. T. Brod & Co. v. Perlow,* 2 Cir. 1967, 375 F.2d 393, 396.

Even if this alleged scheme was not a "manipulative" device within the meaning of Rule 10b-5, Alabama Farm adequately alleged "deception" in the defendants' failure to disclose that the repurchase plan was to be carried out in a manner that would artificially inflate the price of AMFI's stock in order to benefit the defendants personally and in their misrepresentation in the initial press release that the purchases would be carried out in a manner that would not unduly affect the market. The fact that, if this manipulative scheme was intended, some or all of the directors were aware of it, does not negate the element of deception.[9] The requisite "deception" is provided if the disinterested directors or shareholders are misled, because they are fairly viewed as standing in the place of the cor-

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[9] A few courts initially suggested that the knowledge of officers and directors would be attributed to the corporation, thereby negating the element of deception. *See generally* A. Bromberg, 1 Securities Law—Fraud: SEC Rule 10b-5 § 4.7(542) (1977) (hereinafter cited as *Bromberg*) and cases cited therein. This "strict view" has generally been abandoned. *See Bromberg,* § 4.7(542) at 84.55.

porate entity under these circumstances. *See, e.g., Kidwell, supra,* 597 F.2d at 1293; *Goldberg, supra,* 567 F.2d at 215-19; *Wright v. Heizer Corp., supra,* 560 F.2d at 247, 249; *Shell v. Hensley,* 5 Cir. 1970, 430 F.2d 819, 827; *Rekant v. Desser,* 5 Cir. 1970, 425 F.2d 872, 879-82; *Pappas v. Moss,* 3 Cir. 1968, 393 F.2d 865, 869; *see generally,* Note, *Suits for Breach of Fiduciary Duty Under Rule 10b-5 After Santa Fe Industries, Inc. v. Green,* 91 Harv.L.Rev. 1874, 1875, 1881-84 (1978); 1 A. Bromberg, *Securities Law: Fraud* § 4.7 (542) to (544) (1977).

In *Santa Fe Industries, supra,* minority shareholders were "frozen out" of a corporate subsidiary in which they owned shares through a procedure under Delaware corporation law known as the "short-form" merger. This device allows a parent company that owns 90 percent or more of its subsidiary's shares to force the minority to sell their shares. The only remedy available to the minority shareholders if they consider the price offered inadequate is to seek appraisal of the shares in a state court. The minority shareholders brought a 10b-5 action alleging that the majority had breached their fiduciary duty to the minority under state law. In light of the language of the statute, the fact that Congress has left the regulation of shareholder-management relations largely to the states, and the problems posed by overlapping and possibly inconsistent federal and state laws in this area, the Court held that there is no implied cause of action under § 10(b) or Rule 10b-5 for a breach of state law fiduciary duty absent "deception" or "manipulation." 430 U.S. at 477-80, 97 S.Ct. at 1303-04, 51 L.Ed.2d at 494-496.

Applying this test, it noted that although the minority shareholders alleged that the majority stockholder's failure to give advance notice of the merger was a material nondisclosure, if such disclosure had been given, the minority would still have been able to seek relief only through appraisal in the state courts. Therefore, it concluded that this was not a material nondisclosure within the meaning of

§ 10(b) or Rule 10b-5. Because no deception of manipulation was shown, the Court held that the suit failed.

Santa Fe Industries leaves open the question whether, in addition to showing that he could have brought a suit in the state court, a shareholder must show that he would have prevailed in the state court action. *See generally* Note, *Suits for Breach of Fiduciary Duty Under Rule 10b-5 After Santa Fe Industries, Inc. v. Green,* 91 Harv.L.Rev. 1874, 1893-98. The Ninth Circuit has held that he must prove both, *Kidwell, supra,* 597 F.2d at 1294, and the Seventh Circuit appears to have taken a similar approach. *Wright v. Heizer Corp., supra,* 560 F.2d at 250-51. However, in *Goldberg, supra,* the Second Circuit refused to dismiss a claim where a state suit would have been possible, even though there was no allegation that the shareholders would have succeeded. The court did not inquire further into the shareholder's likelihood of success in such a state action.

We hold that all that is required to establish 10b-5 liability is a showing that state law remedies were available and that the facts shown make out a prima facie case for relief; it is not necessary to go further and prove that the state action would have been successful. On the one hand, to require merely the establishment of a theoretical legal claim under state law would be to predicate relief on a hypothetical basis. On the other, to require proof of victory would be in effect to exact the equivalent of a trial of the state claim. The rule that appears to us to be both desirable and practicable steers between Scylla and Charybdis: the plaintiff must show that there is at least a reasonable basis for state relief, but need not prove that the state suit would in fact have been successful.

We turn then to Florida law to apply this standard. Florida law does not provide a state appraisal remedy for shareholders dissenting from their corporation's repur-

chase of its shares,[10] nor does it restrict relief for misconduct in connection with such repurchases to that remedy, unlike the Delaware provisions that governed the merger in *Sante Fe Industries, supra.* Under Florida law, the shareholders or directors could have sought injunctive relief to block the stock-purchase plan if they had been aware of this scheme.[11] Thus, there would have been a reasonable basis to seek relief in state court.

A reasonably prudent stockholder or disinterested director, in making an intelligent decision whether to take steps to stop the repurchase program, would certainly have considered it significant whether management had embarked on a program of maintaining control at the cost of inflating stock prices. Such a tactic might temporarily run up stock prices, but in the long run it might also lead to a complete

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[10] Florida law provides an appraisal remedy for shareholders who dissent from a corporate merger, 18 West's F.S.A. § 607.247 (1977), but there is no such provision applicable to those who dissent from a repurchase of shares.

[11] Under Florida law, directors are quasi-fiduciaries, and are liable to the corporation or the shareholders for breaches of their trust. *E. g., Orlando Orange Groves Co. v. Hale,* 1933, 107 Fla. 304, 144 So. 674, 677; *B. & J. Holding Corp. v. Weiss,* Fla.App. 1977, 353 So.2d 141, 143. " 'Equity will protect a minority shareholder against conduct of the directors which is in breach of the trust confided in them and injurous to the stockholders . . .' " *Orlando Orange Groves, supra,* 144 So. at 677. The Florida courts may enjoin a director from engaging in acts that are unfair to minority shareholders. *See id.* (temporary injunction against misuse of corporate assets); *Ridgeland Development Co. v. Bundy,* 1933, 108 Fla. 246, 146 So. 379 (suit to enjoin directors from cancelling their obligations to pay stock subscriptions and from disposing of corporate assets held sufficient against motion to dismiss); *Belcher v. Schilling,* Fla.App. 1975, 309 So.2d 32 (shareholder derivative action seeking temporary and permanent injunctive relief and mandamus to invalidate proxies directors allegedly obtained from other shareholders by knowingly misleading them held sufficient to state cause of action). *See also Jacobs v. Adams,* 5 Cir. 1979, 601 F.2d 176.

corporate disaster either in terms of management ability or financial weakness. The alleged omission or misrepresentation, therefore, involved material information, *see Santa Fe Industries, supra,* 430 U.S. at 474 n.14, 97 S.Ct. at 1301, 51 L.Ed.2d at 492; *Kidwell, supra,* 597 F.2d at 1239 & n.10; *Goldberg, supra,* 567 F.2d at 219: *cf. TSC Industries, supra,* 426 U.S. at 449, 96 S.Ct. at 2133, 48 L.Ed.2d at 766 (materiality standard in action involving § 14(a) and Rule 14a-9), and *Santa Fe Industries* is distinguishable because in this case there was not full disclosure, manipulation and deception were adequately alleged, and the shareholders might have been able to obtain equitable relief blocking the transaction in state court. Absent full discovery, and perhaps eventual trial, we cannot determine whether deception can be proved.

Alabama Farm's allegation that the defendants caused the corporation to purchase its shares at artificially inflated prices also adequately asserts the "injury" required for a 10b-5 violation. While current market price is commonly considered a fair measure of value, *see, e.g., Kaufmann v. Lawrence,* S.D.N.Y.1974, 386 F.Supp. 12, *aff'd,* 2 Cir. 1975, 514 F.2d 283, this cannot be the measure if the market is distorted by the manipulation. If market price were always considered a fair measure of value, most, if not all, manipulative devices would not be subject to sanction under Rule 10b-5. Manipulation may affect the price even of stock listed on the New York Stock Exchange and traded in large volume; it obviously could have greater impact on the stock of a company traded only over the counter and in relatively small quantities.

Therefore, the argument that AMFI was paying only the market price is plausible, but sophistic. AMFI's stock was traded only over the counter. The number of transactions were, apparently, few. AMFI was certainly the largest buyer in the market and perhaps, save for Alabama Farm, the only one. What AMFI was willing to pay may have

established the market. What would have been a fair price, or the market price absent the influence of AMFI on the market, is, at this time, only a matter of conjecture. It is at this stage, too, a non-sequitur to conclude that, because the stock at one time sold at $45, purchases executed later at an average cost of $8.41 were not at an inflated price. It is conceivable that, but for the alleged scheme, the price at the later date might have averaged $2.00.

It is the vice of the summary judgment at this stage that it was granted before all the disputed facts were known.

The defendants have thus far failed to meet their burden of establishing the absence of any genuine issue of material fact regarding their alleged scheme to inflate the price of AMFI shares. Even though Alabama Farm did not have a full opportunity to conduct discovery, it did uncover some circumstantial evidence suggesting either a scheme to purchase AMFI stock at any price or purchases without regard for the relation of the price paid to the stock's value or to the effect of that price on the market. For example, there was evidence of steady buying by AMFI,[12] and documents obtained from AMFI might lead a trier of fact to conclude that in some instances inflated prices were paid.[13]

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[12] After its first two purchases in January, 1974, AMFI steadily bought over the course of four months, failing to make purchases on only 8 days that the market was open. AMFI might well have been following a policy of steady purchases in small amounts in order to avoid disrupting the market for its stock, and to keep the price down; if so, its actions would be blameless. *See* 3 L. Loss, Securities Regulation at 1551. However, its actions are also susceptible to the inference that it was attempting to support the market over a longer time period than would be the case if it made less frequent, but larger, purchases.

[13] When AMFI began its stock repurchase plan in January, 1974, its first two purchases were made at a price of approximately $6.73 per share. After AMFI's steady purchases during the first four months of 1974, the price of AMFI stock rose, and thereafter AMFI made no purchase below $7.25 per share. In one in-

In addition, the stock repurchase program apparently did cause a serious deterioration of AMFI's policyholder surplus, prompting the Florida Department of Insurance to write AMFI on February 21, 1975 directing it to cease its repurchases. This deterioration in its policyholder surplus occurred at a time, late 1974, when AMFI was also experiencing investment reverses that could have resulted in substantial charges to its statutory capital and surplus if the Department of Florida had deemed the investments to be non-admitted assets.[14] Such charges, at least in conjunction with the depletion in statutory capital caused by the stock repurchase program, might have drastically affected AMFI's ability to write new business.[15] The timing of the repurchase program and the tax incurred as a result of the program's implementation are also circumstantial evidence

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stance AMFI apparently paid as much as $30.12 per share, as its documents show an expenditure of $69,300 for 2,300 shares.

AMFI made no purchases during May, June and July, but actively resumed them in August, 1974. During August the stock was purchased for an average of $8.50 per share, but AMFI's records indicate that it purchased some shares at a price of $22.19 per share and others at a price of $14.18 per share.

[14] AMFI's 10-K filed with the Securities and Exchange Commission in 1974 revealed that one of the projects to which AMFI had made a $3,000,000 mortgage loan was in Chapter X proceedings and AMFI was not then accruing interest on the loan. Additionally, the 10-K indicated that AMFI had received a letter from the Florida Department of Insurance dated March 7, 1975 requesting a meeting with AMFI officials because, as of December 31, 1974, AMFI had $8,700,000 worth of mortgage loans outstanding upon which interest was overdue more than three months. A meeting was mandated because the value of these mortgages exceeded AMFI's current surplus. If the Department had treated the mortgage loans as non-admitted assets, it could have resulted in the statutory insolvency of AMFI; at the end of 1974 the statutory capital and surplus of AMFI totaled only $3,690,996, approximately 42% of the value of the mortgage loans in default.

[15] See footnote 5, *supra*.

from which it might be inferred that the defendants were inflating the price of AMFI stock in order to maintain their control over the corporation or were acting in the knowledge that such inflation would be the necessary result of their conduct. The program was undertaken at the same time as Alabama Farm was making substantial purchases of AMFI stock, and caused AMFI to incur $695,142 in federal income taxes in 1974 alone.[16] Because the inferences to be drawn from these facts are disputed, we cannot determine whether the evidence would support the thesis that there was a scheme to maintain corporate control at any price or that the effect of the repurchase plan, as carried out, was to inflate the price of the stock.

Although the defendants presented affidavits and excerpts from the minutes of meetings of AMFI's Board of Directors to support their assertion that the repurchase program was undertaken simply as a good investment, this was insufficient to eliminate a genuine issue of fact as to the scope and predictable effect of the repurchase program. *See generally* 3 L. Loss, Securities Regulation at 1552-53 (2d ed. 1961). These issues involve subjective fac-

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[16] Under the provisions of the Life Insurance Company Income Tax Act of 1959, Pub.L. 86-69, June 25, 1959, 73 Stat. 112, as amended, an insurance company may place a designated amount of earnings in a "Policyholders' Surplus Account" and avoid paying tax on this income. When distributions are made from this account, such as when an insurer purchases its own shares, the amount of the distribution is added to taxable income for that year, resulting, in effect, in the payment of income taxes on old earnings at corporate income tax rates. *See* 26 U.S.C. §§ 801 *et seq.*

A life insurance company may accumulate income in this account over a number of years. Alabama Farm introduced the affidavit of a witness who testified that most companies strenuously avoid a distribution and resultant taxation on these earnings. In repurchasing its shares, however, AMFI distributed the entire balance of its Policyholders' Surplus Account, voluntarily triggering federal income taxes in one year of $695,142. Purchases made by AMFI in 1975 will receive similar tax treatment.

tors such as the knowledge available to the defendants and their intentions in pursuing the program; determination of these issues may require a full trial to enable the trier of fact to observe the demeanor of the witnesses, particularly during cross-examination *see, Slavin v. Curry, supra;* in conjunction with the genuine issue of fact presented concerning whether the corporation was "injured" by the alleged scheme, they warrant at least the opportunity to continue discovery, for the limited evidence presented by the defendants might have been rebutted if Alabama Farm had been allowed complete discovery, or even if it simply had been allowed access to the complete minutes of AMFI's Board of Directors' meetings. Alabama Farm may be unsuccessful in this action, but it is at least entitled to a fair opportunity to develop its case.[17]

We are well aware of the fact that the mere threat of discovery may cause substantial expenses to be incurred by litigants. In class actions in particular discovery can be used to coerce defendants. Flimsy cases are sometimes undertaken for just such a purpose. However, because the opportunity to have a full trial turns on the presence of still-disputed issues of material fact, a suit that asserts a tenable legal claim must not be aborted. Although Alabama Farm's suit is premised, at this point, on unproved inferences from circumstantial evidence, it states a cause of action and involves disputed issues of fact; therefore, under

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[17] It may be, as the dissent argues, that Alabama Farm is engaged in harassment as a result of frustation of its efforts to gain control of AMFI. The facts with respect to this are, like many others in this case, not known. Alabama Farm brings this action not on its own behalf but on behalf of AMFI, as a derivative stockholder's action. The deception it alleges was, it contends, worked on the corporation. We do not here decide that the suite has merit; we simply hold that its dismissal came before the plaintiffs had adequate opportunity for discovery and, therefore, before it could be known whether there were any genuine disputes as to material facts.

the Federal Rules of Civil Procedure, Alabama Farm has a right at least to further discovery. *See Subin v. Goldsmith, supra,* 224 F.2d at 761.

III. *The Alleged Violations of § 14(a) and Rule 14a-9*

Alabama Farm alleged numerous misstatements and omissions in the proxy materials and supplemental proxy materials issued by AMFI. On consideration of these materials, the district court found that Alabama Farm's allegations were ill-founded. We agree.

None of the alleged misrepresentations and omissions in the proxy materials concerned the adequacy of the disclosure made regarding the scope of the repurchase program or how it would be carried out. In its amended complaint, Alabama Farm did not assert that the proxy statement should have disclosed the alleged intent of the directors to inflate the price of AMFI stock, or that this would necessarily be the result of their actions. If such issues had been raised in the pleadings, summary judgment would have been improper. However, summary judgment was appropriate with respect to the allegations that Alabama Farm did make.

For the reasons set forth above, the grant of summary judgment for the defendants on Count I of the amended complaint is REVERSED, and the grant of summary judgment on Count II is AFFIRMED.

SKELTON, Senior Judge, concurring in part and dissenting in part:

I agree with the holding of the majority that American Fidelity (AMFI) did not violate § 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a) (1970), and Rule 14a-9 of the SEC, 17 C.F.R. § 240.14a-9 (1976) in the mailing of proxy and supplemental proxy statements, because, as held by the district judge, there were no significant misstatements or omissions in the proxy materials.

I also agree with the decision of the majority that AMFI succeeded in establishing the absence of any genuine issue of material fact as to the subjective motivation of its directors and officials in adopting the repurchase program and as to the effect of the program on the company's capital and surplus. The majority correctly approved the action of the district court in finding that the undisputed facts show that the company had adequately disclosed the existence, size and effect of the program, and that Rule 10b-5 does not require corporate directors and officers to disclose their subjective motivation in adopting a stock repurchase program.

I also agree that Counts III and IV involving state claims were properly dismissed.

However, I cannot agree with the majority's decision to reverse the case for a hearing on Alabama Farm's allegations that the repurchase plan was a device to manipulate the market in AMFI's shares and thereby inflate the market price of the shares in order to preserve the defendant's control over the AMFI, and that as a part of this scheme the defendants failed to disclose the inflationary effect AMFI's repurchases would have on the market price of its outstanding shares, all in violation of § 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5. In my opinion, there is no genuine issue as to any material fact regarding these allegations of Alabama Farm and, therefore, a new trial is not warranted.

The majority correctly states:

> "The Supreme Court has cautioned that '"[m]anipulation"' is '" virtually a term of art when used in connection with securities markets."' *Sante Fe Industries, supra,* 430 U.S. at 476, 97 S.Ct. at 1302, 51 L.Ed. 2d at 493, quoting *Ernst & Ernst v. Hochfelder,* 1976, 425 U.S. 185, 199, 96 S.Ct. 1375, 1384, 47 L.Ed.2d 668, 680. 'The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are

> intended to mislead investors by *artificially* affecting market activity.' (Emphasis supplied). *Santa Fe Industries, supra,* 430 U.S. at 476, 97 S.Ct. at 1302, 51 L.Ed.2d at 493-494. 'Manipulation' has referred, in general, to devices used to induce investment in a company's stock, not to devices implemented to discourage such investment."

Notwithstanding the above decisions of the Supreme Court, the majority takes the opposite view and holds that "manipulation" by a corporation refers to devices used by it to *discourage* investment by others in its stock, and that such conduct by AMFI in the instant case acted as a deceit or worked as a fraud on AMFI or on those who have invested in its stock. I do not agree.

There was no deceit nor fraud practiced by AMFI in connection with its repurchase plan. There is no allegation by Alabama Farm of any fact that shows any purpose, plan or intent on the part of AMFI to inflate the market price of its stock by its repurchase plan. Furthermore, the execution of the plan by AMFI did not inflate the market price of its stock. The facts show that the stock was originally issued for $25 a share. Later, and prior to the time of the repurchase plan, it reached $45 a share. Thereafter, it fell to $10 a share. AMFI repurchased its stock for an average of $8.41 a share. Where is the inflated price?

Also, it should be pointed out that Alabama Farm purchased 300,000 shares of AMFI stock (approximately 20% of the then outstanding shares) for the total sum of $2,530,000.00. No one forced it to buy this stock. We can assume that it made these purchases voluntarily and at prices that were satisfactory to it. Where was the deceit or the fraud? In my opinion, they were totally lacking. There was no violation of § 10(b) or Rule 10b-5 by AMFI.

The majority holds that there is a question of fact as to whether AMFI practiced deception in its initial press re-

lease that its purchases would be carried out in a manner that would not unduly affect the market. As a matter of fact, this is exactly what AMFI did. It purchased the stock in small lots over a long period of time. No one was deceived or misled. The price of the stock was not inflated by reason of its purchases.

I agree with the decision of Judge Tjoflat when he, acting as a district judge, granted summary judgment for the defendants on this phase of the case on the ground that Rule 10b-5 was not violated because there was no "deception" of or "injury" to the plaintiffs in connection with the repurchase program. I would add that there is no genuine issue of any material fact on this part of the case.

I would affirm the judgment of the district court on both Count I and Count II.[1]

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[1] In my opinion, this case is much ado about nothing and borders on being frivolous. It is obvious that Alabama Farm evolved a plan to take control of AMFI one way or another. At first it sought to do this by buying 300,000 shares of AMFI's stock. When this plan failed to produce the desired results, it embarked on a course of conduct involving legal harassment, coercion and intimidation to gain control of AMFI. All of this is shown by Alabama Farm's pleading and conduct whereby it filed two suits in Federal courts in two different states and a third in a state court and in connection with such suits, which were consolidated into the present case, it attempted to take 38 depositions and filed 15 motions in connection therewith. These motions were obviously without merit, as the district court never acted on them. As a part of its case, Alabama Farm is making demand on AMFI for $3,423,078 in damages without alleging any fact that would entitle it to even $1 in damages. However, the making of the claim in such a large amount is itself an harassment and an intimidation. It appears to me that AMFI has done no wrong and that Alabama Farm is the bad actor in this scenario. A reversal of this case would enable Alabama Farm to subject AMFI to more harassment and intimidation. I do not think we should allow our courts to be used for such purposes.

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In the Supreme Court of the United States

OCTOBER TERM, 1979

AMERICAN FIDELITY LIFE INSURANCE COMPANY, ET AL., PETITIONERS

v.

ALABAMA FARM BUREAU MUTUAL CASUALTY INSURANCE COMPANY, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether respondent, in this action under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, has raised issues of material fact that preclude a grant of summary judgment in favor of petitioners prior to the completion of discovery.

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This brief is filed in response to the Court's invitation to the Solicitor General to express the views of the United States.

STATEMENT

Respondent brought this derivative action in the United States District Court for the Northern District of Florida on behalf of petitioner American Fidelity Life Insurance Company ("AMFI"), a Florida insurance company. The complaint sought damages from five of AMFI's directors for injury suffered as a result of alleged violations by those directors of Sections 10(b) and 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and 78n(a), and Securities and Exchange Commission Rules 10b-5 and 14a-9 thereunder, 17 C.F.R. 240.10b-5 and 240.14a-9. Even though discovery was still in its preliminary stages (Pet. App. 5a-6a), the district court granted summary judgment against respondent and dismissed its securities law claims with prejudice (Pet. App. 41a).

The court of appeals reversed the district court's grant of summary judgment against respondent on the count of the complaint alleging violations of Section 10(b) and Rule 10b-5.[1] The court concluded that genuine issues of material fact exist with respect to whether the petitioner-directors engaged in a manipulative or deceptive device in connection with AMFI's repurchase of approximately 315,000 shares of its common stock.

The court of appeals determined that the complaint adequately alleged "a scheme artificially to manipulate the market and artificially (that is, beyond the operation of

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[1]The court affirmed the grant of summary judgment against respondent on the count of the complaint alleging violations of Section 14(a) of the Securities Exchange Act of 1934 and SEC Rule 14a-9 (Pet. App. 26a).

normal market factors) to inflate prices" (Pet. App. 14a). That scheme allegedly was intended to discourage other persons from purchasing AMFI stock or attempting to gain control of AMFI in order to perpetuate the petitioner-directors' control of AMFI (Pet. App. 4a-5a, 13a-14a). The court of appeals pointed out that petitioners failed to establish the absence of any genuine issue of material fact as to whether AMFI's stock repurchase program was a manipulative scheme that injured the corporation by artificially inflating the price it paid for its own stock (Pet. App. 2a, 21a-22a).

The court of appeals also determined that respondent raised material issues of fact regarding the adequacy of the disclosure of the stock repurchase program. The court found that there were material issues of fact regarding respondent's claims that the petitioner-directors (i) failed to disclose that the repurchase program would be carried out in a manner that would artificially inflate the price of the stock and (ii) issued a deceptive press release announcing that the repurchase program would be carried out in a manner that would not unduly affect the market (Pet. App. 17a). Since the evidence before the court on petitioners' summary judgment motion did not preclude a determination by the trier of fact that petitioners had manipulated the price of AMFI stock and deceived AMFI, the court remanded the case to the district court for completion of discovery and, if necessary, a trial on the merits (Pet. App. 25a-26a).

In discussing respondent's claim of deception, the court of appeals explained that the fact that some or all of AMFI's directors were aware of the scheme to manipulate the stock did not negate the possibility of deception. AMFI could be deceived, the court observed, if the disinterested directors (the directors who did not stand to benefit personally from the repurchase program) or the

shareholders were misled, since those persons stand in the place of the corporate entity in these circumstances (Pet. App. 17a-18a). The court of appeals also explained that the alleged misrepresentation and nondisclosure could be found to be material because a reasonably prudent shareholder or disinterested director, in deciding whether to take steps to halt the stock repurchase program, would have considered this matter important (Pet. App. 20a). Had they known the truth, the stockholders or disinterested directors could have brought suit in state court to enjoin the repurchase program (Pet. App. 19a).

DISCUSSION

The decision of the court of appeals does not conflict with any decision of this Court. Although there is a conflict among the circuits with respect to one secondary aspect of the decision, that conflict is not of sufficient significance to warrant review by this Court at an interlocutory stage in this proceeding.

1. Petitioners argue (Pet. 11) that, on the "central issue" in this case, the court of appeals has held that an allegation of failure to disclose that a corporate stock repurchase program was motivated by the desire of certain directors to maintain control of the corporation is sufficient to state a claim under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. That determination, petitioners contend, is contrary to the reasoning of *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977), and to decisions of three courts of appeals holding that nondisclosure of directors' motives does not violate the statute and rule.

In our view, however, petitioners' interpretation of the court of appeals' decision is incorrect. While there is language in the court of appeals' opinion that, viewed in isolation, suggests such an interpretation, the opinion

must be read in light of the court's explicit holding that disclosure of motivation is not required. See Pet. App. 11a; see also page 7, *infra*. The court of appeals held that summary judgment in favor of petitioners was premature because there are genuine issues of material fact as to whether the stock repurchase program was a manipulative device that injured the corporation by artificially inflating the price at which it purchased shares of its own stock and as to whether there was adequate disclosure concerning the corporation's stock repurchase program. Neither aspect of the court's decision turns on disclosure of the petitioner-directors' motivation for instituting and carrying out the program. Thus, the legal principles on which the decision of the court of appeals rests do not conflict with either the reasoning of *Santa Fe* or the decisions of the Second, Third and Eighth Circuits cited by petitioners.[2]

a. The court of appeals concluded that the respondent raised genuine issues of material fact as to whether the stock repurchase program was in reality a form of market manipulation used to deter investment in AMFI stock by artificially inflating the market price of those securities.[3] Such activity is manipulation "in th[e] technical sense of

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[2]The court of appeals' decision rests on the well established principle that summary judgment should be granted sparingly in complex cases, particularly when discovery has not been completed, and may not be utilized to resolve genuine issues of material fact. See, *e.g.*, *Poller* v. *Columbia Broadcasting System, Inc.*, 368 U.S. 464, 474 (1962). This Court has reaffirmed that principle in the securities law context. See *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 450 & n.11 (1976).

[3]In so holding the court of appeals relied, not on the petitioner-directors' alleged motive to retain control, but on evidence concerning the manner in which the stock repurchase program was conducted (see Pet. App. 22a-24a). The court's *factual* analysis of the adequacy of the evidence suggesting manipulation that respondent presented does not warrant review by this Court, and we express no view on

artificially affecting market activity in order to mislead investors * * *" (*Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 477), which is prohibited by Section 10(b) and Rule 10b-5(a) and (c).[4] See *United States* v. *Charnay*, 537 F. 2d 341, 350, 351 (9th Cir.), cert. denied, 429 U.S. 1000 (1976) (sales of substantial blocks of a security for the purpose of artificially depressing the market price); *Landy* v. *Federal Deposit Insurance Corporation*, 486 F. 2d 139, 161 (3d Cir. 1973), cert. denied, 416 U.S. 960 (1974).

The court of appeals also held that summary judgment was improper with respect to respondent's claim that the petitioner-directors had deceived AMFI through its disinterested directors and stockholders. Petitioners erroneously argue that the court concluded that "all the material terms of the stock repurchase program and all of the facts relating thereto" had been disclosed, thus leaving disclosure of a "motive" to "main[tain] * * * existing corporate control relationships" as the "only issue" (Pet. 13). The court did not, however, find full disclosure of the facts regarding the repurchase program. To the contrary, it found the existence of genuine issues of material fact regarding (i) whether petitioners failed to disclose that the repurchase program would be conducted in a manner that would artificially inflate the price of AMFI's stock and (ii) whether petitioners falsely stated in a press release that the program would be carried out in a manner that would not unduly affect the market price. As

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that question. If, however, AMFI's purchases were effected in accordance with all the requirements that would be imposed by the Commission's proposed Rule 13e-2, 38 Fed. Reg. 34341 (1973), 35 Fed. Reg. 11411 (1970), as petitioners suggest (Pet. 18 n.12), no adverse inference should be drawn on remand from petitioners' decision not to make "less frequent, but larger, purchases" (Pet. App. 22a n.12).

[4]Section 10(b), 15 U.S.C. 78j(b), prohibits the use in connection with the purchase or sale of securities of "any *manipulative* or deceptive *device* or *contrivance*" in contravention of SEC rules (emphasis supplied).

the Ninth Circuit has correctly noted: "Failure to disclose that market prices are being artificially * * * [affected] operates as a deceit on the market place and is an omission of a material fact." *United States* v. *Charnay*, *supra*, 537 F. 2d at 351. See also *TSC Industries, Inc.* v. *Northway, Inc.*, *supra*, 426 U.S. at 463 & n.24.

b. The legal principles underlying the court's decision that summary judgment in favor of petitioners was improper do not conflict with this Court's reasoning in *Santa Fe Industries, Inc.* v. *Green*, *supra*. In *Santa Fe*, the Court considered a claim that a short-form merger transaction used by the majority stockholder of a corporation to eliminate the minority interest violated Section 10(b) and Rule 10b-5 because there was no valid corporate purpose for the merger and the minority stock was undervalued. The case was presented "on the premise that the complaint failed to allege a material misrepresentation or material failure to disclose." 430 U.S. at 474. This Court concluded that the complaint failed to state a claim for relief because it alleged solely a breach of corporate fiduciary duty, without any element of deception or manipulation.

The court of appeals expressly recognized these governing principles (Pet. App. 7a) but noted that respondent's complaint adequately alleged that petitioners had engaged in a manipulative or deceptive scheme (Pet. App. 13a-14a). The court thus correctly held (Pet. App. 25a) that respondent "is at least entitled to a fair opportunity to develop its case" because petitioners, in seeking summary judgment, failed to establish that their conduct could not "be fairly viewed as 'manipulative or deceptive' within the meaning of the statute." *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 474.

Nor does the decision below conflict with the decisions of the Second, Third, and Eighth Circuits cited by petitioners.[5] The court below specifically rejected respondent's contention that the petitioner-directors' failure to disclose their alleged motive to maintain control violated Rule 10b-5 and noted that cases holding that such disclosure is not required are "sound" (Pet. App. 11a). Agreeing with petitioners on this point, the court stated (*ibid.*):

> Section 10(b) and Rule 10b-5 * * * were not intended to require, under normal circumstances, the disclosure of an individual's motives or subjective beliefs, or his deductions reached from publicly available information.[6]

Thus, this case does not present and we express no view concerning the question whether failure to disclose motivation can constitute a violation of Rule 10b-5.[7]

2. Petitioners also ask this Court to resolve a conflict among the courts of appeals on the question whether, in

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[5] *Rodman* v. *Grant Foundation*, 608 F. 2d 64 (2d Cir. 1979); *Biesenbach* v. *Guenther*, 588 F. 2d 400 (3d Cir. 1978); *Golub* v. *PPD Corp.*, 576 F. 2d 759 (8th Cir. 1978).

[6] The opinion does contain language that, if read in isolation, could lead to the conclusion that the court believed that the subjective motivation of the directors for inflating the market price should be disclosed in addition to the inflationary effect of the purchases and the nature of the scheme (see Pet. App. 17a). However, in view of the court's lengthy discussion of the issue and its express statement that Rule 10b-5 does not require disclosure of motivation, the opinion cannot fairly be read to hold the contrary.

[7] Motivation can, however, constitute evidence pertinent to the question whether petitioners' conduct was manipulative. A motive to manipulate, coupled with a series of stock purchases, can establish a prima facie case of manipulation. See III L. Loss, *Securities Regulation* 1552-1553 (2d ed. 1961); *TSC Industries, Inc.* v. *Northway, Inc.*, *supra*, 426 U.S. at 463 n.24.

certain cases involving deception of a corporation through its disinterested directors or its stockholders. Section 10(b) and Rule 10b-5 require proof that a derivative plaintiff would have been successful in a state court action (Pet. 22-24). While the court below did acknowledge that its position on this question differed from that of the Ninth Circuit and possibly that of the Seventh Circuit (see Pet. App. 19a), we do not believe that the difference requires this Court's review, particularly in the interlocutory procedural posture of this case.

The question raised by petitioners is a subsidiary aspect of the court of appeals' determination that deception of AMFI could be found, even though some or all of the directors authorizing the stock purchase plan were aware of the material facts, if the disinterested directors or the shareholders were misled (see Pet. App. 17a-18a). Petitioners do not challenge this proposition. The courts of appeals that have considered this question have, without exception, agreed that a corporation may be defrauded if persons interested in a corporate securities transaction are in a position to control the decision of the corporation and disclosure of material facts is not made to the disinterested directors or the stockholders.[8] The

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[8]See, *e.g.*, Pet. App. 17a-18a; *Kidwell ex rel. Penfold* v. *Meikle*, 597 F. 2d 1273, 1291-1292 (9th Cir. 1979); *Wright* v. *Heizer Corp.*, 560 F. 2d 236, 249 (7th Cir. 1977), cert. denied, 434 U.S. 1066 (1978); *Goldberg* v. *Meridor*, 567 F. 2d 209, 215-218 (2d Cir. 1977), cert. denied, 434 U.S. 1069 (1978); *Bailey* v. *Meister Brau, Inc.*, 535 F. 2d 982, 993 (7th Cir. 1976); *Shell* v. *Hensley*, 430 F. 2d 819, 827 (5th Cir. 1970); *Rekant* v. *Desser*, 425 F. 2d 872, 879-882 (5th Cir. 1970); *Schoenbaum* v. *Firstbrook*, 405 F. 2d 215, 219-220 (2d Cir. 1968) (en banc), cert. denied, 395 U.S. 906 (1969); *Pappas* v. *Moss*, 393 F. 2d 865, 869 (3d Cir. 1968); *Ruckle* v. *Roto American Corp.*, 339 F. 2d 24, 29 (2d Cir. 1964). See also *Popkin* v. *Bishop*, 464 F. 2d 714, 719-720 (2d Cir. 1972); *O'Neill* v. *Maytag*, 339 F. 2d 764, 768 (2d Cir. 1964). Several of these cases were cited by this Court in *Santa Fe* as

courts of appeals have likewise agreed that, in such cases, a cause of action is stated if shareholders could have taken advantage of available state law remedies to enjoin the transaction if they had been aware of the true facts.[9] Petitioners express no contrary view.

The divergence of views relates only to a secondary question: To establish a claim under Rule 10b-5, must a plaintiff demonstrate that his state court injunctive action would have been successful? Only the Ninth Circuit has held that such a showing must be made. *Kidwell ex rel. Penfold* v. *Meikle*, 597 F. 2d 1273, 1294 (9th Cir. 1979). The Third Circuit, like the court of appeals in this case, has concluded that proof of ultimate success in state court need not be established. *Healey* v. *Catalyst Recovery of Pennsylvania, Inc.*, 616 F. 2d 641, 647 (3d Cir. 1980); Pet.

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examples of cases involving an element of deception. *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 475 n.15.

See also *Maldonado* v. *Flynn*, 597 F. 2d 789, 795 (2d Cir. 1979); *Dasho* v. *Susquehanna Corp.*, 461 F. 2d 11, 25-26 (7th Cir.), cert. denied, 408 U.S. 925 (1972) (knowledge of *disinterested* directors is attributed to the corporation, precluding a finding of deception).

[9]See Pet. App. 19a; *IIT* v. *Cornfeld*, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 97,320 at 97,165 (2d Cir. Mar. 17, 1980); *Kidwell ex rel. Penfold* v. *Meikle*, *supra*, 597 F. 2d at 1291-1292; *Wright* v. *Heizer Corp.*, *supra*, 560 F. 2d at 250; *Goldberg* v. *Meridor*, *supra*, 567 F. 2d at 219-220. See also *Healey* v. *Catalyst Recovery of Pennsylvania, Inc.*, 616 F. 2d 641 (3d Cir. 1980); *SEC* v. *Parklane Hosiery Co.*, 558 F. 2d 1083, 1088 (2d Cir. 1977).

In *Santa Fe*, this Court held that nondisclosure of the terms of a short-form merger prior to completion of the merger was not material where state law afforded only an appraisal remedy and not injunctive relief. Because the plaintiffs "d[id] not indicate how they might have acted differently had they had prior notice of the merger * * *, the failure to give advance notice was not a material nondisclosure within the meaning of the statute or the Rule." *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 474 n.14.

App. 18a-19a.[10] The Seventh Circuit was able to conclude, after a full trial, that the plaintiff would have succeeded in state court and did not reach the question whether proof of success was essential. *Wright* v. *Heizer Corp.*, 560 F. 2d 236, 250-251 (7th Cir. 1977), cert. denied, 434 U.S. 1066 (1978).[11]

In our view, the approach adopted by the court of appeals here—requiring only that the plaintiff "make out a prima facie case for [state court] relief" (Pet. App. 19a)—is both sound and practical. Indeed, in the present procedural posture of this case, it is difficult to see how the court of appeals could have applied any other standard. Respondent has not yet completed discovery and thus has not yet developed evidence sufficient to establish conclusively that a state court action would have been successful. In resisting a motion for summary judgment at this preliminary stage of a lawsuit, a plaintiff who claims injury because a fact omitted or misrepresented in connection with a securities transaction would be important in pursuing an available state law remedy against the transaction need only meet the ordinary standards applicable to a party opposing summary judgment. See *TSC Industries, Inc.* v.

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[10]In *Healey*, *supra*, the plaintiff, a minority shareholder, sued under Section 10(b) and Rule 10b-5 in his individual capacity for damages and an injunction to bar a merger approved by shareholder vote. A majority shareholder repeatedly had failed to provide the plaintiff with information that the court of appeals found would have created a "reasonable probability of ultimate success" in a state court action to enjoin the merger. 616 F. 2d at 647.

[11]In *Goldberg* v. *Meridor*, *supra*, 567 F. 2d at 220-221, the Second Circuit did not address the question whether a state court injunction would have been obtained. See also *ITT* v. *Cornfeld*, *supra*, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 97,320 at 97,165.

Northway, Inc., supra, 426 U.S. at 450; see also *Healey* v. *Catalyst Recovery of Pennsylvania, Inc., supra*, 616 F. 2d at 647-648.[12]

There are additional reasons why review by this Court of the decision of the court of appeals is inappropriate at this time. As previously noted, the court of appeals determined that respondent raised genuine issues of fact not only with respect to its claim of deception, but also with respect to its claim of market manipulation. Thus, there is an independent basis for the decision of the court of appeals remanding the present case for further proceedings. In addition, due to the interlocutory posture of the present case (see *Brotherhood of Locomotive Firemen* v. *Bangor & Aroostook R.R.*, 389 U.S. 327, 328 (1967)), it is impossible to determine whether the legal issue that petitioners seek to litigate in this Court will be dispositive of the present case. On remand, after an opportunity for "full discovery" (Pet. App. 21a), respondent may be unable to demonstrate that the stock repurchase program was carried out in a manner that artificially inflated the market price of AMFI stock. The

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[12]The court of appeals' conclusion that the plaintiff must make a prima facie showing of entitlement to relief in state court avoids the necessity of a full-blown trial of the state law claim in federal court (as would be required under the Ninth Circuit's view) and also avoids the undesirable consequence of permitting a meritless claim to go to the jury. See also *Healey* v. *Catalyst Recovery of Pennsylvania, Inc., supra*, 616 F. 2d at 648, noting that the district court should "determine whether any of that information could have been used to obtain a [state court] injunction. If there was as a matter of law no reasonable probability of ultimate success, the information is not material." Of course, a plaintiff seeking damages under Section 10(b) based on omission or misrepresentation of information in connection with a stock transaction must prove, in addition to materiality (*TSC Industries, Inc.* v. *Northway, Inc., supra*), that the defendants acted with scienter (*Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976)), and that the violation caused an ascertainable injury (*Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 389 (1970)).

question whether the omitted or misrepresented fact—the program's alleged manipulative nature—should have been disclosed would then become moot. Resolution of the state law relief question may thus be irrelevant to the ultimate outcome of this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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